

## Seattle Rule 5-045

### Allocation and Apportionment Methods

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(1) Introduction. Beginning January 1, 2008, RCW 35.102.130 established new allocation and apportionment requirements for cities with a gross receipt business tax. The new allocation procedure requires businesses to allocate or source their sales of tangible personal property to the local jurisdiction where delivery takes place. The new apportionment procedures require businesses that report under the service and other business activities tax classification to apportion their gross income based on a two-factor formula. The two factors are "payroll" and "service revenue." (See allocation and apportionment procedures below.)

In an effort to recoup a major portion of the tax revenue lost under RCW 35.102.130, the City of Seattle imposed the square footage business tax on any taxpayer who received a tax reduction benefit from RCW 35.102.130. (See Seattle Rule 5-930 for the square footage business tax information.) The square footage business tax was imposed starting January 1, 2008.

For many taxpayers, these allocation and apportionment requirements have created confusion and administrative hardships. The intent of this rule is to provide guidance on the new allocation and apportionment methods.

(2) Persons conducting all business activities within Seattle-- Reporting Instructions. Any taxpayer whose sales and services are delivered wholly within the city of Seattle (does not engage in any business activity outside of Seattle) is allowed to take a 100% credit against their square footage business tax. Since all of their sales and services are delivered within Seattle the new allocation and apportionment procedures do not change their tax reporting requirements. They should compute their business license tax in the same manner as they have historically reported the tax and then take a 100% credit against their square footage business tax.

(3) Extracting, Manufacturing, Printing, Transporting Freight for Hire, Processing for Hire, and Tour Operator reporting instructions. For periods both before and after January 1, 2008, taxpayers engaged in extracting, manufacturing, printing, transporting freight for hire, processing for hire and tour operator activities, shall report the activity in the location where the activity takes place. This means that there will be no change in their reporting requirements. Persons engaged solely in such activities are exempt from the square footage business tax.

(4) Royalty Income. Gross income derived as royalties from the granting of intangible rights shall be allocated to the commercial domicile (headquarters) of the taxpayer.

(5) Retail/Wholesale reporting methods. In order to compute the amount of square footage business tax credit, the following explains the methods for reporting revenue under the retailing/wholesaling classifications of the business license tax:

(a) Retail/Wholesale revenue assignment prior to January 1, 2008. Revenue reported under either the retailing or wholesaling classification of the business license tax is assigned to the City of Seattle as follows:

(i) A person who maintains an office or place of business in the City shall be taxable on the gross income, gross proceeds of sales, or value of products derived from the business activities rendered by, generated from, or attributable to the office or place of business located within the City, unless specific deductions or exemptions apply.

(ii) A person engaging in business activities in the City who does not maintain an office or place of business in the City shall allocate to the City that portion of the taxpayer's gross income or gross proceeds of sales that are derived from business activities performed in the City.

(iii) A person who maintains an office or place of business in the City and also elsewhere.

(A) Shall be taxable on that portion of his gross income or gross proceeds of sales, or value of products that is derived from business activity rendered by, generated from, or attributable to the office or place of business located within the City, unless specific deductions or exemptions apply; and

(B) Shall allocate to the City and be taxable on gross income, or gross proceeds of sales, from business activities performed in the City but supported by the office or place of business located outside the City, where the business activity performed in the City is a significant factor in making or holding the market for the goods or services sold; and

(C) Delivery of product or the performance of services occurs in Seattle; or

(D) The customer is located in Seattle.

(iv) The amount derived from goods delivered outside of the State of Washington by the seller may be deducted from the gross income.

(v) The amount derived from goods delivered into other cities or local jurisdiction that maintain an eligible gross receipts tax and subject to the tax may be deducted from the gross income. Also see the provisions for the Multiple Activity Tax Credit (MATC) when goods are extracted, manufactured, or printed in Seattle or in another city that imposes an eligible gross receipt tax.

(b) Retail/Wholesale revenue assignment beginning January 1, 2008. Revenue earned after December 31, 2007 and reported under either the retailing or wholesaling classification of the business license tax is assigned to the City of Seattle if the goods or services are delivered within the city and the taxpayer has nexus within the city. Goods delivered by a Seattle seller to a point outside of the city may be deducted from the gross proceeds of sales (includes both intrastate and interstate deliveries).

(6) Service Income Reporting Methods. In order to compute the square footage business tax credit, the following explains the different methods for reporting income reportable under the service and other business activities classification of the business license tax:

(a) Service revenue assignment prior to January 1, 2008. This section instructs taxpayers which revenues reported under the service and other business activities classification of the business license tax will be assigned to the City as taxable. Once the amount subject to tax in Seattle is determined according to this section, then the credit or deductions contained in SMC 5.45.070 and SMC 5.45.075 may be calculated, if applicable.

(i) A person who maintains an office or place of business in the City shall be taxable on the gross income, gross proceeds of sales, or value of products derived from the business activities rendered by, generated from, or attributable to the office or place of business located within the City, unless specific deductions or exemptions apply.

(ii) A person engaging in business activities in the City who does not maintain an office or place of business in the City shall allocate to the City that portion of the taxpayer's gross income or gross proceeds of sales that are derived from business activities performed in the City.

(iii) A person who maintains an office or place of business in the City and also elsewhere.

(A) Shall be taxable on that portion of his gross income or gross proceeds of sales, or value of products that is derived from business activity rendered by, generated

from, or attributable to the office or place of business located within the City, unless specific deductions or exemptions apply; and

(B) Shall allocate to the City and be taxable on gross income, or gross proceeds of sales, from business activities performed in the City but supported by the office or place of business located outside the City, where the business activity performed in the City is a significant factor in making or holding the market for the goods or services sold, and

(C) The performance of services occurs in Seattle; or

(D) The customer is located in Seattle.

(iv) Allocations of amounts shall be made in accordance with and in full compliance with the provisions of the interstate commerce clause of the United States Constitution where applicable.

(v) In cases where the taxpayer maintains an office or place of business in Seattle and conducts activities outside of Washington which create taxing nexus and the person has licensed and pays any applicable taxes to the other jurisdiction, then the apportionment of revenue shall be made using a two-factor formula of payroll and service income. In this case the payroll and service income factors will be computed based upon Multi-State Tax Commission guidelines as follows:

(A) The payroll factor is based on employees' (FICA employees) compensation paid within Seattle compared to total employees' compensation. Payroll is paid within Seattle if:

(1) The employee's service is performed entirely within Washington.

(2) The employee's service is performed both within and without Seattle, but the service performed outside Washington is incidental to the employee's service within Washington. "Incidental" means any service which is temporary or transitory in nature.

(3) If the employee's services are performed both within and without Washington the employee's compensation will be attributed to Seattle: (i) if employee's base of operation is in Seattle; or (ii) if the place from which the employee's services are directed or controlled is in Seattle; or (iii) if the base of operations or the place from which the service is directed or controlled is not in any city in which some part of the service is performed but the employee's residence is in Seattle.

(B) The service income factor is based on the income produced within Washington and not tax by another eligible gross receipt tax city compared to total income produced everywhere. Income is produced within Washington if:

- (1) The income producing activity is performed wholly within Washington; or
- (2) The income producing activity is performed both in and outside of Washington and a greater proportion of the income producing activity is performed in Washington than any other location, based on cost of performance. "Cost of performance" means direct costs determined in a manner consistent with generally accepted accounting principles. Included in the taxpayer's cost of performance are the taxpayer's payments to an agent or independent contractor for the performance of personal services, or the utilization of tangible and intangible property, which give rise to the particular item of income and provided directly to the taxpayer's customer. If this subsection (6)(a)(v) applies and you have questions concerning the procedures, then contact the Revenue and Consumer Affairs Division to ask for assistance.

(vi) If the Director determines that the allocation of gross income from business activities taxable under the "other business activities" classification (SMC 5.45.050 G) and subject to this subsection (6)(a) does not fairly reflect gross income derived from business activities within the City, the Director shall determine such gross income by either of the following methods: (a) by a fair and equitable formula agreed upon by the Director and the taxpayer after a consideration of the facts; or (b) by the ratio that the cost of doing business within the City bears to the cost of doing business both within and without the City. For cost apportionment purposes, all costs must be assigned to an office location.

(b) Service revenue apportioned beginning January 1, 2008. Gross income derived from service and other business activities taxed under SMC 5.45.050 G after January 1, 2008 shall be apportioned to the City by multiplying the service and other business activity income by a fraction, the numerator of which is the payroll factor plus the service and other business activity income factor and the denominator of which is two (2).

(i) The payroll factor is a fraction, the numerator of which is the total amount paid for compensation in the City during the tax period by the taxpayer and the denominator of which is the total compensation paid everywhere during the tax period. Compensation is paid in the City if:

(A) The individual or employee is primarily assigned within the City;

(B) The individual is not primarily assigned to any place of business for the tax period and the employee performs fifty percent (50%) or more of his or her service for the tax period in the city; or

(C) The individual is not primarily assigned to any place of business for the tax period, the individual does not perform fifty percent (50%) or more of his or her service in any city, and the employee resides in the city.

(ii) The service and other business activity income factor is a fraction, the numerator of which is the total service and other business activity income of the taxpayer in the City during the tax period, and the denominator of which is the total service and other business activity income of the taxpayer everywhere during the tax period. Service and other business activities income is in the City if:

(A) The customer location is in the City; or

(B) The income-producing activity is performed in more than one (1) location and a greater proportion of the service-income-producing activity is performed in the City than in any other location, based on costs of performance, and the taxpayer is not taxable at the customer location; or

(C) The service and other business activity income producing activity is performed within the City, and the taxpayer is not taxable in the customer location.

(iii) The definitions in this subsection apply throughout this rule.

(A) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid to individuals for personal services that are or would be included in the individual's gross income under the federal Internal Revenue Code.

(B) "Individual" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

(C) "Customer location" means the city or unincorporated area of a county where the majority of the contacts between the taxpayer and the customer take place.

(D) "Primarily assigned" means the business location of the taxpayer where the individual performs his or her duties.

(E) "Service-taxable income" or "service income" means gross income of the business subject to tax under the service and other business activity classification, including but not limited to royalty income.

(F) "Taxable in the customer location" means either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so.

(7) Examples. The following examples identify a number of facts and then state a conclusion. The tax status of each circumstance must be determined after a review of the agreement and all of the facts and circumstances.

(a) Company ABC is a retail store located in Seattle. ABC ships approximately 25% of their merchandise to customers outside of Seattle. Of the 25% shipped outside of Seattle, 5% is shipped in their own trucks into other cities with a gross receipt tax such as Bellevue, Burien, and Everett. Bellevue, Burien and Everett tax those sales. Under the new allocation procedure ABC can deduct the twenty-five percent (25%) of their sales that is delivered outside Seattle. Because ABC has received a gross receipt business license tax benefit under the new allocation procedure through this new deduction, they would owe Seattle's new square footage business tax. Since ABC is paying a gross receipts B & O tax on eighty percent (80%) of their sales (75% to Seattle and 5% to other cities) ABC would receive an eighty (80%) credit against their square footage tax and have to pay 20% (twenty percent) of the square footage business tax computed.

(b) BAM Company is a Seattle CPA firm that conducts audits and provides consulting services to business both within and outside Seattle. Beginning January 1, 2008, BAM should report under the new apportionment procedures and use the two-factor formula of payroll and service revenue. BAM will incur Seattle's new square footage business tax in the same percentage that they benefit under the two-factor formula when compared to the old code method of reporting (method used prior to January 1, 2008). The old code required that they report all of their intrastate revenues and take a deduction for any services rendered within other gross receipts B & O cities and having paid their tax.

(c) Company MMM reports under the service and other business activity classification and has its only business location in Seattle. MMM maintains contracts with independent contractors who sell the company's services. The independent contractors are paid by commissions. The independent contractors are located partly outside of the state and partly within the state. MMM employees managers that visit the independent contractors but are assigned to the Seattle office. Company MMM has nexus outside of the state due to their independent contractors working with MMM's ultimate customer. MMM should compute their

taxable service and other income using the two-factor method. Since their employees and the traveling managers are assigned to the Seattle office, 100% of the payroll is assigned to Seattle. The service and other income generated by their independent contractors in out-of-city locations would be sourced to outside of Seattle and only that service and other income generated from employees or independent contractors within the city shall be assigned to Seattle. Assuming that 75% of the service and other income is generated outside of Seattle and 25% inside of Seattle, then the two factor apportionment would be as follows:

$100\% \text{ (Seattle payroll factor)} + 25\% \text{ (Seattle income factor)} / 2 = 62.5\%$   
apportionment factor. 62.5% of MMM's total service and other income would be assigned to Seattle for tax purposes.

According to this rule Company MMM should have been using the two factor method contained in paragraph (6)(a)(v) above prior to January 1, 2008, and then used the two factor method contained in paragraph (6)(b) above beginning on January 1, 2008. If a tax reduction benefit was received under the two factor method computed according to paragraph (6)(b), then the square footage tax would be owed based on the same percentage that MMM benefited under the new two factor method. For example if MMM received a 10% reduction in the business license tax under the two factor method computed pursuant to paragraph (6)(b), then MMM would owe 10% of their square footage tax. MMM would receive a credit for the other 90% of their square footage tax.

Effective: April, 2008

Amended: January, 2009.

#### DIRECTOR'S CERTIFICATION

I, Dwight Dively, Finance Director of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Executive Administration.

DATED this \_\_\_\_ day of January, 2009

CITY OF SEATTLE,

a Washington municipality

By: \_\_\_\_\_

Dwight Dively, Director

Finance Department



Jan 23, 2009