

City Business & Occupation (B&O) Tax Required Updates Effective January 1, 2008

Why the Change?

In 2003, the Legislature passed EHB 2030 (RCW 35.102), the city B&O legislation. The law requires the 39 cities with local B&O taxes to adopt allocation and apportionment provisions as part of an updated city B&O tax model ordinance by January 1, 2008. (RCW 35.102.130)

What is Changing?

Allocation and Apportionment of Income

Under current law, these activities are taxed in the jurisdiction where the selling or service activity takes place, and credits apply if a business pays tax in another jurisdiction. Selling and service activities on the same transaction can take place in two or more cities. Under the new change, specific rules for allocating and apportioning revenues to jurisdictions in which it engages in business for tax purposes will apply and will vary depending on the classification under which revenue is reported:

Allocation:

- Manufacturing/Extracting/Retail Services: allocated to the location where the **activity takes place**
- Retail Sales: the activity takes place where **delivery to the buyer** occurs (similar to state sales tax changes to “destination-based sourcing” that take effect on July 1, 2008)
- Wholesale Sales: the activity takes place where **delivery to the buyer** occurs
- Royalties from the Granting of Intangible Rights: allocated to the **commercial domicile** of the taxpayer

Apportionment:

Services and Other: apportioned to a city by multiplying service income by a payroll factor (based on the payroll within the jurisdiction), plus the service-income factor (based on the income producing activity attributable for tax purposes within the jurisdiction), divided by two:

$$\text{Total services income} \times (\text{Payroll Factor} + \text{Service-Income Factor}) / 2$$

- Payroll Factor = Total Compensation in City/Total Compensation Everywhere

Compensation is paid in the city if:

- (i) The individual is **primarily assigned** within the city;
- (ii) The individual is not primarily assigned to any place of business for the tax period and the **employee performs 50% or more** of his or her service for the tax period in the city; or
- (iii) The individual is not primarily assigned to any place of business for the tax period, the individual does not perform 50% or more of his or her service in any city, and the **employee resides in the city**.

“Primarily assigned” is defined as the business location of the taxpayer where the individual performs her or her duties. What is meant by “business location of the taxpayer?” This must be a place of business, store, or office.

- Service Income Factor = Service Income in City/Service Income Everywhere

Service income is in the city if:

- (i) The **customer location** is in the city; or
- (ii) The income-producing activity is performed in more than one 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
- (iii) The **service-income-producing activity is performed within the city**, and the taxpayer is not taxable in the customer location.

“Customer location” is defined as the city or unincorporated area of a county where the “majority of the contacts” between the taxpayer and the customer takes place. The term is not a commonly used term in other tax apportionment methods.

continued

Other Changes

- Specific provisions also apply to newspaper and publishing businesses to exempt them from apportionment requirements. (RCW 35.102.150)
- Specific exemptions apply in rare cases of professional employer services – e.g. shared receptionist services in office building. (This does not apply in a temporary employment agency situation.)
- Updates to penalties and interest provisions in administrative provisions – linked to RCW to accommodate any future changes.
- Other definitional changes: definition of delivery, updates in sales at retail for telephone services.

Examples	Current Law	Post-Allocation & Apportionment Changes
Manufacturing:		
A firm manufactures goods in City A and sells goods those same goods wholesale in City B.	100% to City A, the manufacturing city, under multiple activities rules.	100% to City A under multiple activities rules – no change in allocation: allocated to “where the manufacturing activity takes place.”
Retail/Wholesale Sales:		
A firm ships via common carrier from its warehouse in City A to a homeowner in City B. The firm has no physical presence in City B, such as salespeople calling on homeowners or other customers.	City A would tax the activity since City B has no taxing nexus.	Under RCW 35.102.130(1)(a), the “activity” takes place in City B. City A cannot tax the sale. City B would only be able to tax if the firm had nexus in the city.
Same fact pattern, but the firm has a physical presence, in City B, such as a store or salespersons visiting customers.	City B would tax the activity and give a credit for any taxes paid in City A.	Under RCW 35.102.130(1)(a), the “activity” takes place in City B. Because the firm has taxable nexus in City B, City B would be allocated the revenue from this delivery. City A cannot tax.

Examples	Current Law	Post-Allocation & Apportionment Changes
Services:		
<p>An accounting firm located in City A conducts the annual tax audit for a business in City B. To complete this particular audit, it assigns staff to work at the customer's location for several weeks. Assume that the payroll factor allocates the revenue from this customer to City A. Since the majority of contacts occur in City B, the service income factor allocates the revenue to City B. Taxpayer has nexus in City B due to physical presence.</p>	<p>City A can tax 100% of revenue unless City B is a gross receipt B&O tax city and the majority of the service is conducted in City B. Then City B gets 100% of revenue.</p>	<p>City A would receive 50% and City B would receive 50%.</p> <p>City A = service income x (payroll factor (=1) + service income factor (=0)) / 2 = service income x (1 + 0) / 2 = service income x 1/2</p> <p>City B = service income x (payroll factor + service factor/2) = service income x (0 + 1) / 2 = service income x 1/2</p>
<p>A City C (a non-B&O tax city) engineering firm has multiple customers in City A. They do not come into City A to meet with their clients, but conduct their business over the phone and through emails and meet at various construction sites south of City A. They advertise and send mailers and bids to City A construction firms.</p>	<p>No nexus, no activity, and no tax.</p>	<p>No nexus, apportionment would not apply to activities in City A.</p>
<p>Same facts, but they also meet in City A with one of their customers but none of the others. City C has all of the payroll costs and City A's customer represents 40% of the service income.</p>	<p>100% of the revenue attributable to customers or activities in City A to City A.</p>	<p>All of payroll allocated to City C and 40% of services income to City A. 20% apportioned via service income formula to City A.</p> <p>City A = service income x (payroll factor + service income factor) / 2 = service income x (0 + 4/10) / 2 = service income x 1/5</p>

