
SENATE BILL 6637

State of Washington 58th Legislature 2004 Regular Session

By Senators Zarelli, Prentice and Rasmussen

Read first time 01/27/2004. Referred to Committee on Ways & Means.

1 AN ACT Relating to apportionment of gross income taxable under RCW
2 82.04.290 for entities engaging in business activities both within and
3 outside this state; amending RCW 82.04.297 and 82.04.460; adding a new
4 section to chapter 82.04 RCW; and creating a new section.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

6 NEW SECTION. **Sec. 1.** The legislature finds that, in order to
7 comply with the interstate commerce clause for apportionment purposes,
8 the department of revenue has construed the phrase "maintaining a place
9 of business" in existing law to mean engaging in activities that would
10 subject a taxpayer to tax under chapter 82.04 RCW if performed in this
11 state.

12 Furthermore, the legislature finds that one area in which
13 apportionment problems arise is with regard to service activities
14 provided by internet service providers engaging in business activities
15 inside and outside Washington. Internet service providers engaging in
16 business activities in Washington and in other states need an equitable
17 way to apportion to this state that portion of their gross income
18 earned from providing such services in Washington.

1 The legislature intends to affirm the department of revenue's
2 construction of existing law and to provide a method by which internet
3 service providers can equitably apportion their gross receipts among
4 the states in which they provide internet services.

5 **Sec. 2.** RCW 82.04.297 and 2000 c 103 s 5 are each amended to read
6 as follows:

7 (1) The provision of internet services is subject to tax under RCW
8 82.04.290(2).

9 (2) The definitions in this subsection apply throughout this
10 chapter.

11 (a) "Electronically supplied service" means a service that is
12 taxable under RCW 82.04.290(2) and that relies on the internet for its
13 operation, is automated, and involves only occasional and incidental
14 human intervention. "Electronically supplied service" includes, but is
15 not limited to:

16 (i) Services that provide a web site or web page, or support a
17 business or personal presence on the internet, or a proprietary
18 subscriber network;

19 (ii) Services that are automatically generated from a computer, via
20 the internet or a proprietary subscriber network, in response to
21 specific data input by the customer; or

22 (iii) Internet advertising services and enhanced internet
23 advertising services.

24 (b) "Electronically supplied service" does not include any services
25 taxable under RCW 82.04.290(2) if the only use of the internet is to
26 deliver the work product.

27 (c) "Enhanced internet advertising services" means business
28 arrangements that solely involve listing products or services on a web
29 site in conjunction with the performance of additional business
30 activities, including activities such as electronic order taking,
31 payment processing, auction listings, and other similar arrangements
32 that connect buyers and sellers through the internet.

33 (d) "Human intervention" does not include the creation or
34 acquisition of content that is stored electronically and made available
35 for access by customers via the internet nor does it include customer
36 or technical support services provided to assist customers in the use
37 of an electronically supplied service.

1 (e) "Internet" means the international computer network of both
2 federal and nonfederal interoperable packet switched data networks,
3 including the graphical subnetwork called the world wide web.

4 ~~((3))~~ (f) "Internet advertising services" means advertising,
5 marketing, and solicitations that are conducted solely on or through
6 the internet or on internet web sites and involves the provision of
7 advertising, marketing, and solicitations via the internet using sound,
8 video, banners, click-through, hyperlinks, metatags, text, and
9 graphical representations.

10 (g) "Internet service" means a service that includes computer
11 processing applications, provides the user with additional or
12 restructured information, or permits the user to interact with stored
13 information through the internet or a proprietary subscriber network.
14 "Internet service" includes provision of internet electronic mail,
15 access to the internet for information retrieval, and hosting of
16 information for retrieval over the internet or the graphical subnetwork
17 called the world wide web. The term also includes an electronically
18 supplied service.

19 **Sec. 3.** RCW 82.04.460 and 1985 c 7 s 154 are each amended to read
20 as follows:

21 (1) Except as otherwise provided in this section, any person
22 ~~((rendering services))~~ engaging in business activities in this state
23 taxable under RCW 82.04.290, and ~~((maintaining places of business both~~
24 ~~within and without this state which contribute to the rendition of such~~
25 ~~services))~~ engaging in business activities outside this state that
26 contribute more than incidentally to such in-state activities, shall,
27 for the purpose of computing tax liability under RCW 82.04.290,
28 apportion to this state that portion of ~~((his))~~ gross income ~~((which~~
29 ~~is))~~ derived from ~~((services rendered))~~ business activities performed
30 within this state. Where such apportionment cannot be accurately made
31 by separate accounting methods, the taxpayer shall apportion to this
32 state that proportion of ~~((his))~~ total income which the cost of doing
33 business within the state bears to the total cost of doing business
34 both within and without the state.

35 (2) ~~((Notwithstanding the provision of subsection (1) of this~~
36 ~~section,))~~ Persons doing business both within and without the state who
37 receive gross income from service charges, as defined in RCW 63.14.010

1 (relating to amounts charged for granting the right or privilege to
2 make deferred or installment payments) or who receive gross income from
3 engaging in business as financial institutions within the scope of
4 chapter 82.14A RCW (relating to city taxes on financial institutions)
5 shall apportion or allocate gross income taxable under RCW 82.04.290 to
6 this state pursuant to rules (~~promulgated~~) adopted by the department
7 consistent with uniform rules for apportionment or allocation developed
8 by the states.

9 (3) The department shall by rule provide a method or methods of
10 apportioning or allocating gross income derived from sales of telephone
11 services taxed under this chapter, if the gross proceeds of sales
12 subject to tax under this chapter do not fairly represent the extent of
13 the taxpayer's income attributable to this state. The rules shall be,
14 so far as feasible, consistent with the methods of apportionment
15 contained in this section and shall require the consideration of those
16 facts, circumstances, and apportionment factors as will result in an
17 equitable and constitutionally permissible division of the services.

18 (4) Any person subject to tax under this chapter engaging in the
19 activity of providing internet services in this state, and engaging in
20 business activities outside this state that contribute more than
21 incidentally to such in-state activity, shall apportion to this state
22 that portion of gross income derived from internet service activity
23 performed within this state as provided in section 4 of this act.

24 (5) Activities performed outside the state contribute more than
25 incidentally to in-state activities only to the extent that such
26 activities would subject the taxpayer to the tax under this chapter if
27 performed in this state.

28 NEW SECTION. Sec. 4. A new section is added to chapter 82.04 RCW
29 to read as follows:

30 (1) The apportionable income of an internet service provider shall
31 be apportioned to Washington by multiplying the income by a fraction,
32 the numerator of which is the property factor plus the payroll factor
33 plus eight times the sales factor, and the denominator of which is ten.
34 The denominator shall be reduced by the number of missing factors, if
35 any. If the sales factor is missing, the denominator shall be reduced
36 by eight. A factor is missing if both the numerator and denominator of
37 that factor are zero.

1 (2)(a) The property factor is a fraction, the numerator of which is
2 the average value of real and tangible personal property owned or
3 rented and used by the taxpayer in this state during the tax period and
4 the denominator of which is the average value of all the taxpayer's
5 real and tangible personal property owned or rented and used during the
6 tax period. For purposes of computing the property factor, "property"
7 includes a co-location arrangement pursuant to which the taxpayer is
8 granted the right to locate computer or telecommunication equipment in
9 an equipment room, cage, rack, or similar space.

10 (b) Property owned by the taxpayer is valued at its original cost.
11 Property rented by the taxpayer is valued at eight times the net annual
12 rental rate. The net annual rental rate is the annual rental paid by
13 the taxpayer less any annual rental received by the taxpayer from
14 subrentals. Property occupied under a co-location arrangement is
15 valued at eight times the annual consideration paid for the right to
16 occupy space in an equipment room, cage, rack, or similar space. If
17 property is rented by the taxpayer or occupied under a co-location
18 arrangement at no charge or at a nominal rate or a rate not otherwise
19 ascertainable, the net annual rental rate or other charge for that
20 property shall be determined on the basis of a reasonable market rental
21 rate for such property.

22 (c) For purposes of computing the property factor, "property"
23 includes prewritten computer software as defined by RCW 82.04.215.

24 (i) Prewritten computer software included in the property factor is
25 allocated to the location where it is used.

26 (ii) The value of the software includes mandatory maintenance
27 agreements and shall be its original cost, or in the case of rented or
28 leased software, the value shall be equal to eight times the annual
29 rental, license, or lease price.

30 (d) The average value of property shall be determined by averaging
31 the values at the beginning and end of the tax period. The department
32 may require the averaging of monthly values during the tax period if
33 reasonably required to reflect properly the average value of the
34 taxpayer's property.

35 (e) Property used in the production of nonapportionable income
36 shall be excluded from the numerator and denominator of the property
37 factor. Property used in the production of both apportionable and
38 nonapportionable income shall be partially excluded from the numerator

1 and denominator of the property factor to exclude, to the extent
2 possible, the portion of property producing the nonapportionable
3 income.

4 (3)(a) The payroll factor is a fraction, the numerator of which is
5 the total amount of compensation paid in this state to employees of the
6 taxpayer during the tax year by the taxpayer and the denominator of
7 which is the total compensation paid to employees of the taxpayer
8 everywhere during the tax year by the taxpayer. Compensation related
9 to the production of both apportionable and nonapportionable income
10 shall be partially excluded from the numerator and denominator of the
11 payroll factor to exclude, to the extent possible, the portion of
12 compensation related to the production of nonapportionable income.

13 (b) Compensation is paid in this state if:

14 (i) The individual's service is performed entirely within this
15 state;

16 (ii) The individual's service is performed within and without this
17 state, but the service performed without this state is incidental to
18 the individual's service within this state;

19 (iii) A portion of the service is performed within this state and
20 the base of operations of the individual is in this state;

21 (iv) A portion of the service is performed within this state and,
22 if there is no base of operations, the place from which the
23 individual's service is directed or controlled is in this state;

24 (v) A portion of the service is performed within this state and
25 neither the base of operations of the individual nor the place from
26 which the service is directed or controlled is in any state in which
27 some part of the service is performed, but the individual's residence
28 is in this state; or

29 (vi) The individual is neither a resident of nor performs services
30 in this state but is directed or controlled from an office in this
31 state and returns to this state periodically for business purposes and
32 the state in which the individual resides does not have authority under
33 the United States Constitution to impose on the employer a gross
34 receipts tax. For this purpose a gross receipts tax is any tax imposed
35 on or measured by the gross volume of business, and in the
36 determination of which the deductions allowed would not make the tax a
37 net income or value added tax, and the tax is not, pursuant to law or
38 custom, separately stated on customer invoices.

1 (c) "Compensation" means wages, salaries, commissions, and any
2 other form of remuneration paid to or accrued to employees for personal
3 services. Employer contributions under a qualified cash plan, deferred
4 arrangement plan, and nonqualified deferred compensation plan are
5 included in the payroll factor. Stock based compensation is included
6 in the payroll factor to the extent included in gross income for
7 federal income tax purposes.

8 (4)(a) The sales factor is a fraction, the numerator of which is
9 the total receipts of the taxpayer from providing internet services in
10 this state during the tax period, and the denominator of which is the
11 total receipts of the taxpayer from providing internet services
12 everywhere during the tax period.

13 (b) For purposes of computing the sales factor, internet services
14 are considered provided in this state if:

15 (i) Except as provided in (c) of this subsection, the receipt of
16 the service by the purchaser occurs in this state as determined by
17 instructions provided by the purchaser to the taxpayer regarding
18 delivery of any tangible personal property to which the service
19 relates;

20 (ii) The address for the purchaser is located in this state as
21 indicated by the business records of the taxpayer maintained in the
22 regular course of business, and (b)(i) of this subsection does not
23 apply;

24 (iii) The address for the purchaser obtained during consummation of
25 the sale, including any address of a purchaser's payment instrument
26 when readily available to the taxpayer and no other address is
27 available, is located in this state, and (b)(i) and (ii) of this
28 subsection do not apply; or

29 (iv) The commercial domicile of the taxpayer is in this state, and
30 (b)(i), (ii), and (iii) of this subsection do not apply.

31 (c)(i) Notwithstanding any other provision in this section to the
32 contrary, the sale of internet advertising services is considered
33 provided in this state in the ratio that internet usage in this state
34 bears to the total internet usage in the United States.

35 (ii) Internet advertising is not considered provided in this state
36 if the web site displaying the advertising predominantly uses a
37 language spoken by less than fifteen percent of Washington residents

1 and does not have a United States universal resource locator ending in
2 .biz, .net, .org, .com, or other similar United States universal
3 resource locator.

4 (d) Notwithstanding any other provision in this section to the
5 contrary, the sale of enhanced internet advertising that constitutes an
6 internet service is considered provided in this state in the ratio that
7 the number of service purchasers in this state bears to the total
8 service purchasers purchasing the taxpayer's enhanced internet
9 advertising services in the United States.

10 (5)(a) If the apportionment provisions of this section do not
11 fairly represent the extent of its business activity in this state, the
12 taxpayer may use, or the department may prospectively require, in
13 respect to all or any part of the taxpayer's business activity of
14 providing internet services:

15 (i) Separate accounting;

16 (ii) A calculation of tax liability using the cost of doing
17 business method outlined in RCW 82.04.460(1);

18 (iii) The exclusion of any one or more of the apportionment
19 factors;

20 (iv) The inclusion of one or more additional apportionment factors
21 that will fairly represent the taxpayer's business activity in this
22 state; or

23 (v) The employment of any other method to effectuate an equitable
24 apportionment of the gross income of the taxpayer derived from business
25 activity in this state.

26 (b) The party seeking to apply this subsection (5) has the burden
27 to prove by clear, cogent, and convincing evidence that:

28 (i) The apportionment provisions of this section do not fairly
29 represent the extent of taxpayer's business activity in this state; and

30 (ii) The proposed alternative does fairly represent the extent of
31 taxpayer's business activity in this state.

32 (c) If a taxpayer uses an alternative apportionment method
33 permitted under this subsection (5) in preparing its return, a
34 statement describing such alternative method must be filed with such
35 return to which the alternative method relates. In the event a
36 taxpayer fails to file such a statement disclosing the use of an
37 alternative apportionment method, the department may disregard the use
38 of such method and apply the general apportionment provisions of this

1 section. A taxpayer may not use more than one method of apportionment
2 for each calendar year, or part thereof, during which the taxpayer is
3 subject to the taxes imposed under this chapter. A taxpayer seeking to
4 use an alternative apportionment method must apply the same method to
5 all tax periods in which an assessment for taxes may be made under RCW
6 82.32.050(3) and that involves the same material facts.

7 (6) The definitions in this subsection apply throughout this
8 section.

9 (a) "Apportionable income" means income derived from providing
10 internet services and subject to apportionment under RCW 82.04.460(4)
11 after exclusions, deductions, and exemptions, but before apportionment.

12 (b) "Internet service provider" means a person who provides
13 internet services and who is entitled to apportion under RCW
14 82.04.460(4).

15 (7) The department shall adopt such rules as may be necessary to
16 administer the provisions of this section, including rules for the
17 measurement of internet usage which shall, to the extent reliably
18 available, be based on published statistics of internet usage. In the
19 absence of published statistics of internet usage the department may
20 use any reasonable method of measurement, including population or other
21 demographic data published by the United States census bureau.

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