

WA amends nexus standards, rate preference, M&E exemption, and penalties

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Overview

Washington State recently enacted its budget, Engrossed Substitute Senate Bill 6138 (SB 6138),¹ which makes various changes to Washington tax law. Notable provisions of the new law include:

- Adding remote seller click-through nexus for sales and use tax purposes
- Extending the economic nexus standard to the business and occupation (B&O) tax wholesaling classification
- Eliminating a B&O tax rate preference for royalty income
- Expanding the manufacturing machinery and equipment exemption to certain software manufacturers
- Increasing late payment penalties

In this Tax Alert we summarize these law changes.

Remote seller click-through nexus for sales and use tax²

Washington has joined approximately 20 other states in adopting remote seller click-through nexus provisions. These provisions impose retail sales tax collection requirements on a remote seller (such as catalogue or online retailer) that enters into an agreement with a resident located in Washington for the purpose of soliciting sales on behalf of the remote seller. Effective September 1, 2015,³ the new law provides that a remote seller is required to collect and remit Washington sales and use tax if “substantial nexus” with Washington exists. A presumption of substantial nexus exists if:

- The remote seller enters into an agreement with a Washington resident under which the resident, for a commission or other consideration, refers potential customers to the remote seller through a link on the resident’s internet website or otherwise; and
- The cumulative gross receipts from sales by the remote seller to customers in Washington through all such agreements exceed \$10,000 during the preceding calendar year.⁴

A remote seller may rebut this presumption by providing proof that each Washington resident with whom the remote seller has an agreement did not engage in any activity that was significantly associated with the remote seller’s ability to establish or maintain a market in Washington for the remote seller’s products or services during the calendar year in question.⁵

Economic nexus standard for B&O tax wholesaling classification

As of June 1, 2010, Washington adopted two separate “substantial nexus” standards for B&O tax purposes—physical presence nexus and economic nexus⁶—that apply depending on a taxpayer’s B&O tax classification. Physical presence nexus currently applies to businesses making retail sales⁷ or wholesale sales.

¹ Chapter 5, 2015 Laws, 3rd Special Session (E.S.S.B. 6138; signed by Gov. Inslee, Jul. 1, 2015). A copy of the adopted law is accessible [here](#).

² See, footnote 7, *infra*, regarding the application of “click-through” nexus for B&O tax purposes under the retailing classification.

³ SB 6138, Sec. 501(2).

⁴ SB 6138, Sec. 202, adding a section to be codified between Wash. Rev. Code. § 82.08.050 and § 82.08.054.

⁵ SB 6138, Sec. 202, adding a section to be codified between Wash. Rev. Code. § 82.08.050 and § 82.08.054.

⁶ The term “economic” nexus derives from the “Economic Nexus Minimum Thresholds” Excise Tax Advisory 3195.2015, Washington Department of Revenue (February 3, 2015).

⁷ SB 6138 also amends the B&O definition of “physically present in [Washington]” such that a remote seller with substantial nexus—as provided under the click-through nexus provisions added by SB 6138, Section 202, applicable to sales and use tax—will be deemed to have satisfied the physical presence nexus requirement for reporting B&O tax under the retailing classification. See, SB 6138, adding Sec. 501(6)(c)(ii).

The economic nexus standard currently only applies to apportionable activities.⁸ Apportionable activities include activities categorized under the “service and other activities” B&O tax classification, the business activity of receiving royalty income, and other activities specified in Wash. Admin. Code § 458-20-49401(2)(a). Under the economic nexus standard, such businesses do not need to have physical presence to have B&O tax nexus. As of 2013, economic nexus is established by having in any tax year:

- More than \$53,000 of property in Washington;
- More than \$53,000 of payroll in Washington;
- More than \$267,000 of receipts sourced to Washington; or
- At least 25 percent of total property, total payroll, or total receipts in Washington.⁹

Effective August 1, 2015,¹⁰ SB 6138 eliminates the physical presence nexus standard as applied to wholesaling activities¹¹ and subjects those activities to the economic nexus standard.¹² Accordingly, a business making wholesale sales to Washington customers must review its Washington receipts, payroll, and property to determine whether any of the economic nexus thresholds are met, even if the business does not have a physical presence in Washington. For purposes of counting receipts toward the dollar amount thresholds listed above, receipts from wholesale sales are sourced to Washington according to the Streamlined Sales and Use Tax Agreement sourcing provisions set forth in Wash. Rev. Code § 82.32.730.¹³

Also effective August 1, 2015, SB 6138 amends the economic nexus standard such that a taxpayer satisfying any one of the economic nexus thresholds in “the immediately preceding” tax year (as opposed to the currently applicable “in any tax year” standard) will have substantial nexus.¹⁴

Repeal of preferential B&O tax rate for royalty income

Under current law, gross income from royalties is apportioned using a single factor receipts method and taxed at a rate of 0.484 percent.¹⁵ This tax rate was adopted in 1998 (lowered from 1.5 percent) to align software royalty receipts with the tax rates for software manufacturing receipts. Gross royalty income includes compensation for the use of intangible property such as copyrights, patents, licenses, franchises, trademarks, trade names, and similar items.¹⁶

Effective August 1, 2015,¹⁷ SB 6138 eliminates the preferential tax rate for royalty income, thereby subjecting such income to tax at the 1.5 percent rate.¹⁸

Manufacturing machinery and equipment exemption for software manufacturers

In 1995, Washington enacted legislation that exempted machinery and equipment used by a manufacturer in a manufacturing operation from the retail sales tax. Effective August 1, 2015,¹⁹ SB 6138 amends the definition of “manufacturer” to include a person that is engaged in the development of prewritten computer software that is not transferred to purchasers by means of tangible storage media.²⁰

The new law also provides that this exemption does not apply to an “ineligible person,” defined as an affiliated group or member of an affiliated group if:

- At least one member of the affiliated group was registered to do business in Washington prior to July 1, 1981;

⁸ Wash. Rev. Code. § 82.04.067(6).

⁹ Wash. Rev. Code. § 82.04.067(1)(c). The dollar thresholds are adjusted from time-to-time based on inflation. The dollar thresholds were last adjusted in 2013 and remain unchanged in 2014 and 2015. See Excise Tax Advisory 3195.2015, Washington Department of Revenue, (February 3, 2015).

¹⁰ SB 6138, Sec. 501(2).

¹¹ SB 6138, Sec. 203, amending Wash. Rev. Code. § 82.04.067(6).

¹² SB 6138, Sec. 203, amending Wash. Rev. Code. § 82.04.066.

¹³ SB 6138, Sec. 204, adding Wash. Rev. Code. § 82.04.067(4)(c).

¹⁴ SB 6138, Sec. 203, amending Wash. Rev. Code. § 82.04.067(1)(c).

¹⁵ Wash. Rev. Code. § 82.04.2907(1).

¹⁶ Wash. Rev. Code. § 82.04.2907(2).

¹⁷ SB 6138, Sec. 501(1).

¹⁸ SB 6138, Sec. 101, amending Wash. Rev. Code. § 82.04.2907(1).

¹⁹ SB 6138, Sec. 501(1).

²⁰ SB 6138, Sec. 301, adding Wash. Rev. Code. § 82.08.02565(2)(d)(ii).

- The affiliated group has a combined employment exceeding 40,000 full-time and part-time employees in Washington as of August 1, 2015; and
- The business activities of the affiliated group primarily include the development, sales, and licensing of computer software services.²¹

Increase in late payment penalties

Effective August 1, 2015,²² SB 6138 increases late payment penalties as follows:

- 9 percent (increased from 5 percent) of the amount of tax due if payment is not received by the due date
- 19 percent (increased from 15 percent) of the amount of tax due if payment is not received on or before the last day of the month following the due date
- 29 percent (increased from 25 percent) of the amount of tax due if payment is not received on or before the last day of the second month following the due date.²³

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²¹ SB 6138, Sec. 301, adding Wash. Rev. Code. § 82.08.02565(4).

²² SB 6138, Sec. 501(1).

²³ SB 6138, Sec. 401, amending Wash. Rev. Code. § 82.32.090(1).