

## Washington B&O tax financial institution apportionment rule modified

### Overview

The Washington Department of Revenue (Department) recently adopted emergency rule amendments to Washington Administrative Code (WAC) 458-20-19404 (Emergency Rule 19404),<sup>1</sup> which became effective January 1, 2016, and address how financial institutions must apportion gross income for Washington business and occupation (B&O) tax purposes when they engage in business both within and outside of Washington.

WAC 458-20-19404 was originally drafted in accordance with RCW 82.04.460(2), which requires the Department, to the extent feasible, to draft and adopt a separate B&O tax apportionment rule applicable for financial institutions that is consistent with the Multistate Tax Commission's (MTC) "Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions" (Recommended Formula). Exceptions to this requirement are that i) the definition of a "financial institution" within the Recommended Formula's appendix is advisory only for B&O tax purposes, and ii) only the receipts factor must be used to apportion gross income for B&O tax purposes.<sup>2</sup>

On July 29, 2015, the MTC approved amendments to its Recommended Formula, including amendments on how the receipts factor is calculated, and these changes became effective January 1, 2016. In response and consistent with its rulemaking mandate, the Department has adopted Emergency Rule 19404 to remain consistent with the MTC's changes to the Recommended Formula. Accordingly, taxpayers classified as "financial institutions" for B&O tax purposes must adhere to Emergency Rule 19404 for tax periods beginning on or after January 1, 2016.<sup>3</sup> The revisions incorporated within Emergency Rule 19404 may significantly impact the B&O tax liability of financial institution taxpayers beginning January 1, 2016.

This Tax Alert summarizes some of the more significant changes to the financial institution B&O tax apportionment requirements that have been incorporated within Emergency Rule 19404, as well as discusses some related taxpayer considerations.

### Change 1

Emergency Rule 19404(3)(i) modifies the definition of "financial institution" to exclude certain "loan servicers," "check cashers" and "check sellers."

### Change 2

Emergency Rule 19404(4)(b) expands the types of income included in the numerator of the receipts factor under the income attribution requirements explained in this section to include "interest, fees, and penalties imposed in connection with loans secured by real property." The original version of WAC 458-20-19404(4)(b) had merely addressed the receipts factor calculation for "interest from loans secured by real property," and explained that the numerator of the receipts factor only included "interest and fees or penalties in the nature of interest" if the property securing the loans was located in Washington.

### Change 3

Emergency Rule 19404(4)(c) expands the types of income included in the numerator of the receipts factor under the income attribution requirements explained in this section to include "interest, fees, and penalties imposed in connection with loans not secured by real property." The original version of WAC 458-20-19404(4)(c) had merely addressed the receipts factor calculation for "interest from loans not secured by real property," and explained that the numerator of the receipts factor only included "interest and fees or penalties in the nature of interest" from loans not secured by real property if the borrower was located in Washington.

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<sup>1</sup> Emergency WAC 458-20-19404—see Rulemaking-Order, CR-103E, Effective January 1, 2016, adopting emergency WAC 458-20-19404, *Financial institutions-Income apportionment*. A copy of the adopted emergency rule is accessible [here](#).

<sup>2</sup> RCW 82.04.460(2)(a) and (b)

<sup>3</sup> Note that Emergency Rule 19404 will remain in effect until April 26, 2016, unless the Department adopts a permanent rule prior to this date. The Department has since correspondingly proposed to amend WAC 458-20-19404 on a permanent basis to remain consistent with the MTC's Recommended Formula changes for periods beginning on or after January 1, 2016. More specifically, the Department filed a Form CR-102, notice of "Proposed Rule Making" on January 6, 2016, providing notice that it is working towards adoption of a permanent version of amended WAC 458-20-19404 for tax periods beginning on or after January 1, 2016. In addition, the Department is also proposing permanent adoption of WAC 458-20-19404A, which would apply to the period June 1, 2010, through December 31, 2015. Proposed Rule WAC 458-20-19404A is currently the same as the original version of WAC 458-20-19404 in effect during that same period.

#### Change 4

Emergency Rule 19404(4)(g) adds separate sections to specifically address the income attribution requirements for “debit card issuer’s reimbursement fees” and “other card issuer’s reimbursement fees.” The original version of WAC 458-20-19404(4)(g) had merely addressed the receipts factor calculation for “credit card issuer’s reimbursement fees.”

#### Change 5

Emergency Rule 19404(4)(h) modifies the receipts factor calculation requirements for “receipts from merchant discount,” and requires income attribution based on the “location” of the merchant rather than the “commercial domicile” of the merchant as had been required under the original version of WAC 458-20-19404(4)(h).

#### Change 6

Emergency Rule 19404(4)(i) is an entirely new section that has been added to the rule that explains the receipts factor calculation requirements for “receipts from ATM fees.” The original version of WAC 458-20-19404 had not specifically addressed the apportionment of ATM fees.

#### Change 7

Emergency Rule 19404(4) has essentially eliminated the “activity-based” income attribution requirements for “receipts from services” that were included in the original version of WAC 458-20-19404(4)(j) by deleting the following language:

(j) Receipts from services. The numerator of the receipts factor includes receipts from services not otherwise apportioned under this subsection (4) if the service is *performed* in this state. If the service is performed both inside and outside this state, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this subsection (4), if a *greater proportion of the activity producing the receipts is performed in this state based on cost of performance*.

In lieu of this deleted language, Emergency Rule 19404(4)(l) adds a new “catch-all” section addressing the attribution of “all other receipts” for receipts factor purposes and states that “[t]he numerator of the receipts factor includes all other receipts from engaging in activities subject to tax under RCW 82.04.290 pursuant to the rules set forth in WAC 458-20-19402 Single factor receipts apportionment—Generally.” Accordingly, receipts that are taxable under the “service and other activities” B&O tax classification and that are not otherwise included in any of the specifically enumerated income buckets provided in Emergency Rule 19404(4), must be apportioned using the market-based general apportionment requirements explained in the Department’s general apportionment rule, WAC 458-20-19402.

#### Considerations

Certain changes incorporated within Emergency Rule 19404 may potentially benefit some financial institutions with a substantial operational presence in Washington by lowering their annual B&O tax liability relative to the amount calculated under the original version of WAC 458-20-19404. Conversely, for some out-of-state financial institutions with little or no operational presence in Washington certain changes incorporated within Emergency Rule 19404 may potentially result in an increased B&O tax liability. Ultimately, however, the implications of the recent changes incorporated within Emergency Rule 19404 are dependent on the specific facts and circumstances of each taxpayer. Accordingly, taxpayers may wish to consult with their tax advisers regarding these modifications, including how the changes may impact their previous B&O tax single receipts factor calculation methodology. Because the changes imbedded in Emergency Rule 19404 are relatively substantial, an apportionment methodology review may be warranted for many financial institution taxpayers.

#### Contacts

If you have questions regarding Emergency Rule 19404, the original version of WAC 458-20-19404, or other Washington tax matters, please contact any of the following Deloitte Tax professionals:

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