

State Ruling

**203-746, Tax Determination No. 13-0397-- Business and occupation-- Constitutional limitations-- Apportionment-- Reliance on oral advice from department of revenue representative**

¶203-746. Tax Determination No. 13-0397, Washington Department of Revenue, 33 WTD 424, August 28, 2014.

**Business and occupation: Constitutional limitations: Apportionment: Reliance on oral advice from department of revenue representative.**— Purported incorrect oral advice from a Washington Department of Revenue representative regarding the proper application of the business and occupation (B&O) tax apportionment methodology set forth in WAC 458-20-19402 did not provide a basis for waiving assessments of tax, penalties, and interest. The taxpayer operated an Internet marketing business in Washington, providing web design and other services, and sold the services to customers in Washington and outside the state. Effective June 1, 2010, WAC 458-20-19402 significantly changed the apportionment rules for service businesses. For the 2011 period at issue, the auditor correctly applied the apportionment methodology required by the rule in computing the taxpayer's taxable income for purposes of the service and other activities B&O tax assessment. Washington law provides that taxpayers have the right to rely on specific, official written advice and written tax reporting instructions from the department. However, this right does not include the right to rely on oral advice.

Cite as Det. No. 13-0397, 33 WTD 424 (2014)

**BEFORE THE APPEALS DIVISION DEPARTMENT OF REVENUE STATE OF WASHINGTON**

In the Matter of the Petition for Correction of Assessment of ...

**DETERMINATION**

No. 13-0397

Registration No....

[1] RCW 82.32A.020; ETA 3065.2009: WAIVER OF ASSESSMENT - ORAL INSTRUCTIONS. The Department lacks authority to waive assessment of taxes, penalties, and interest, based on oral instructions. RCW 82.32A.020 only provides authority to waive taxes based upon reliance on specific, official written advice or written reporting instructions from the Department.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Eckholm, A.L.J. - An Internet marketing business appeals a tax assessment asserting that the assessment should be waived because, when it reported and paid its excise taxes, it relied on oral advice from a Department representative regarding the proper application of the apportionment methodology set forth in WAC 458-20-19402 (Rule 19402). The taxpayer's petition is denied.<sup>1</sup>

**ISSUE**

Whether purported incorrect oral advice from a Department representative regarding the proper application of the apportionment methodology set forth in Rule 19402 provides a basis for waiving assessments of tax, penalties, and interest.

**FINDINGS OF FACT**

[The taxpayer] operates an Internet marketing business in Washington providing services that include web design, search engine optimization, research, and strategy. The taxpayer sells its

services to Washington customers and customers outside the state. The taxpayer has no property or payroll outside of Washington. The business does not pay taxes to any other state, and performs all the services from Washington State. In June 2011, the taxpayer amended its excise tax returns and requested a refund claiming that most of its sales were out of state, and that based on the new apportionment method effective June 1, 2010, as set forth in Rule 19402, it was due a refund of taxes paid on sales that should have been apportioned out of state. The Department of Revenue (Department) granted the taxpayer the requested refund. Subsequently, the Department's Audit Division reviewed the taxpayer's records for excise tax purposes for the period December 1, 2008, through December 31, 2011. The auditor discovered that for the periods in which Rule 19402 was applicable, the taxpayer had incorrectly applied the apportionment formula. The taxpayer indicated to the auditor that it had applied the apportionment formula as it was advised by telephone by a Department representative.

The auditor explained to the taxpayer that effective June 1, 2010, Rule 19402 significantly changed the apportionment rules for service businesses and that revenue from service activities is apportioned to Washington based on a receipts factor formula. The auditor advised that under the new apportionment methodology, income is apportioned to Washington by multiplying a business's apportionable income by the receipts factor, and that for any apportionable activity, the numerator of the receipts factor is the business's gross annual income attributable to Washington State, and the denominator is the business's gross annual income received worldwide from that activity [less throw-out income]. The audit report set forth the apportionment methodology the auditor used in reconciling the taxpayer's revenue for the applicable periods.

...

As a result of the reconciliation of the taxpayer's revenue, an assessment was issued in the total amount of \$..., which included an assessment of services and other activities business and occupation (B&O) tax of \$..., for the period June 1, 2010, through December 31, 2011, as a result of recalculating the taxpayer's apportionable income according to Rule 19402.<sup>2</sup>

The taxpayer appealed the assessment and seeks waiver of the \$... assessment of service and other activities B&O tax because it relied on telephonic instructions from a Department Representative regarding the proper application of the Rule 19402 apportionment methodology in determining its Washington tax liabilities.

#### **ANALYSIS**

Effective June 1, 2010, "... any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state." RCW 82.04.460. "Apportionable income" includes gross income of the business generated from engaging in "apportionable activities." RCW 82.04.460(4)(a). A taxpayer's apportionable income is apportioned to Washington by multiplying its apportionable income by the receipts factor. RCW 82.04.462(1). "Apportionable activities" include activities subject to service and other activities B&O tax. RCW 82.04.460(4)(a)(vi). Apportionable activities are measured by the gross income of the business and B&O tax may only be imposed if a person has a substantial nexus with this state. WAC 458-20-19401(1) (Rule 19401). Rule 19401 sets forth the minimum nexus thresholds for apportionable activities, including the receipts threshold. The receipts threshold is met if a taxpayer receives more than \$250,000 from apportionable activities that is attributed to

Washington. Rule 19401(6).[<sup>3</sup>]

Rule 19402 is the Department's rule implementing RCW 82.04.462, and explains how to calculate the receipts factor as follows:

(401) General. The receipts factor is a fraction that applies to apportionable income for each calendar year. Taxpayers must calculate a separate receipts factor for each apportionable activity (business and occupation tax classification) engaged in.

(402) Receipts factor calculation. The receipts factor is: Washington attributed apportionable receipts divided by world-wide apportionable receipts less throw-out income (see subsection (403) of this section). The receipts factor expressed algebraically is:

		(Washington apportionable receipts)
(Receipts factor)	=	
		((Worldwide apportionable receipts) - (Throw-out income))

- (a) The numerator of the receipts factor is: The total apportionable receipts attributable to Washington during the calendar year from engaging in the apportionable activity.
  - (b) The denominator of the receipts factor is: The total (worldwide, including Washington) apportionable receipts from engaging in the apportionable activity during the calendar year, less throw-out income.
- ...

(403) Throw-out income. Throw-out income includes all apportionable receipts attributed to states where the taxpayer:

- (a) Is not taxable ...; and
- (b) At least part of the activity of the taxpayer related to the throw-out income is performed in Washington.

For the 2011 period at issue in this appeal, the auditor correctly computed [the denominator of] the taxpayer's [receipts factor as] world-wide apportionable receipts [less]... the taxpayer's ... [throw-out income] (receipts from all Canadian provinces and all other U.S. states [except California]). The ... taxpayer's 2011 California receipts of \$389,057.12, ... [were not throw out income] because those receipts met the substantial nexus receipts threshold of \$250,000, according to WAC 458-20-19401(6). The taxpayer's receipts for the other U.S. states and

Canadian provinces were [throw-out income <sup>4</sup>] ... <sup>5</sup> The auditor correctly applied the apportionment methodology required by Rule 19402 in computing the taxpayer's taxable income for purposes of the service and other activities B&O tax assessment.

The taxpayer asserts that it applied the apportionment methodology as instructed by a Department representative by telephone and that it should not be assessed tax, penalties and interest for its reliance on purported incorrect advice. Though the Department endeavors to provide taxpayers information and assistance in determining their tax liability, the Department cannot waive tax liability on the basis of asserted oral instructions from a Department representative.

As persons doing business in Washington, taxpayers have certain responsibilities, some of which are outlined in RCW 82.32A.030, including the responsibility to "[k]now their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue." RCW 82.32A.030(2). In addition to the responsibilities listed in RCW 82.32A.030, certain taxpayer rights are stated in RCW 82.32A.020, including:

- (2) The right to rely on specific, official *written* advice and *written* tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment;

(Emphasis added.) This right does not include the right to rely on oral advice. The Department has issued an advisory statement that explains the Department's position regarding oral instructions. Excise Tax Advisory (ETA) 3065 reads, in part:

The Department of Revenue gives consideration, to the extent of discretion vested in it by law, where it can be shown that failure of a taxpayer to report correctly was due to written instructions from the department or any of its authorized agents. The Department cannot give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a Department employee.

There are three reasons for this ruling:

- (1) There is no record of the facts which might have been presented to the agent for his consideration.
- (2) There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.
- (3) There is no evidence that such instructions were completely understood or followed by the taxpayer.

...  
While it is understandable that a taxpayer may encounter difficulty in applying a new methodology in determining its tax liability, the taxpayer has provided no basis for the Department to waive any portion of the assessment. The taxpayer's petition is denied.

#### **DECISION AND DISPOSITION**

The taxpayer's petition is denied.

Dated this 26th day of December 2013.

#### **Footnotes**

1	Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
2	Document No. 201304856 included assessments of service and other activities B&O tax of \$..., use tax and/or deferred sales tax of \$..., a reversal of the small business credit of \$..., interest of \$... , and an assessment penalty of \$..., for a total amount of \$.....
3	[WAC 458-20-19405 explains the adjustment to the \$250,000 receipts threshold. The current receipts threshold per that rule is \$267,000. This threshold is subject to future adjustment.]
4	[The taxpayer's receipts for the other U.S. states and Canadian provinces were thrown-out income because the taxpayer was not subject to tax in those jurisdictions, the taxpayer did not satisfy Washington's economic nexus standards (the receipts attributed to each was below \$250,000 and 25% of total receipts), and part of the services were performed in Washington.]
5	Audit No. 196036, Workpaper B.