No. 55391-1-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

City of Tacoma, a Washington Municipal Corporation, through its Finance Department, Tax & License Division; and City of Tacoma, Office of the Hearing Examiner,

***Respondents*,**

v.

Sound Inpatient Physicians, Inc.,

***Petitioner*.**

PETITION FOR REVIEW

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I. IDENTITY OF PETITIONER

Petitioner Sound Inpatient Physicians, Inc. ("SIP") asks the Supreme Court to accept review of the Court of Appeals decision terminating review designated in Part II of this petition.

II. COURT OF APPEALS DECISION

The decision at issue was published by Division Two of the Court of Appeals on April 5, 2022. *See Sound Inpatient Physicians, Inc. v. City of Tacoma*, --- P.3d ---, 2022 WL 1013331 (April 5, 2022). A copy of the decision ("Op.") is in the Appendix at pages A-2 through A-15.

III. ISSUES PRESENTED FOR REVIEW

1. Whether the 233 percent disparity in the overall apportionment factor between using SIP's actual Tacoma service income and the service income Tacoma deemed in the City raises significant questions under the United States Constitution?

2. Whether that constitutional infirmity arises from the Court of Appeals' misinterpretation of the statutory language in two respects, one of which is in conflict with a published decision by Division One?

3. Whether the real-world effects of the Court of Appeals' decision, including a complete lack of guidance or guardrails for taxpayers and taxing jurisdictions apportioning income, raises practical problems of substantial public importance?

IV. STATEMENT OF THE CASE

This case implicates the apportionment of SIP's income for purposes of measuring the business and occupation taxes (i.e., "B&O" or "gross receipts" taxes) owed to the City of Tacoma.

A. B&O Tax Apportionment

During the time period at issue, 2013 to 2017, Washington permitted cities to impose a B&O (i.e., gross receipts) tax only by allocating and apportioning it in strict

accordance with RCW 35.102.130. Fairly apportioning taxes to reflect the amount of business done in the taxing jurisdiction, as opposed to in other jurisdictions, is compelled both by statute and by the federal Constitution.

Tacoma, like many other cities in Washington, enacted B&O tax laws that adopted verbatim the required allocation and apportionment from State law. Tacoma Mun. Code ("TMC") ch. 6A.30 (enacting RCW 35.102.130 as a city ordinance). For ease of reference, this petition (like the Court of Appeals' decision) focuses on the state law provisions.[1] Op. at 4 n.2.

Jurisdictions use a variety of factors to fairly apportion taxes. Washington cities use two equally weighted factors:

- **service income**, which represents the proportion of service income in the city, RCW 35.102.130(3)(b); and

[1] The parties and the Court of Appeals agree that the 2017 version of RCW 35.102.130, appended at A-16 to A-18, applies to this case. Op. at 5 n.3. The citations herein are to that version of the statute.

- **payroll**, which represents the proportion of compensation the taxpayer paid in the taxing jurisdiction. RCW 35.102.130(3)(a).

By averaging the proportion of service income in the taxing jurisdiction and the proportion of payroll paid in the taxing jurisdiction, the taxing jurisdiction attempts to fairly apportion income to itself as opposed to other jurisdictions in which the company engages in business.

The dispute here is over how to apportion SIP's service income and whether the resulting, overall apportionment was constitutional.[2] Washington law prescribed how to determine whether service income was in Tacoma:

> 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

[2] The parties agree on SIP's payroll factor, which ranged from 26.38 percent to 50.86 percent. CP 121-22.

> 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**.

RCW 35.102.130(3)(b) (emphasis added). The terms bolded above are defined in the statute:

- "Customer location" means where most of the physical contacts between the taxpayer and the customer take place. RCW 35.102.130(4)(d); *Wedbush Securities, Inc. v. City of Seattle*, 189 Wn. App. 360, 364 66, 358 P.3d 422 (2015).
- "Taxable in the customer location" means that the taxpayer is either actually subject to a gross receipts tax in the customer location, or that the customer location's government "has the authority to subject the taxpayer" to a gross receipts tax. RCW 35.102.130(4)(h).

The City took the position that it was entitled to choose between clauses (i), (ii), and (iii). It chose clause (ii), and even

though SIP engaged in business throughout the country and had a geographically broad footprint and customer base, discussed below, Tacoma deemed every dollar of SIP's service income in Tacoma.

B. SIP's Operations

SIP provides managerial and administrative services to groups of doctors and other medical professionals. CP 113, 233.[3] SIP's customers during the relevant timeframe—66 medical practices in 39 states—in turn served hospitals and skilled nursing facilities. CP 114, 120, 136, 234-35.

It is uncontested that most of SIP's activity for which it earned fees from customers occurred outside Tacoma. CP 613-15. More of its employees worked outside Tacoma (61.25 percent) than in Tacoma (38.75 percent), many of SIP's

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[3] The Hearing Examiner numbered the Administrative Record by stamping "CP###" in bold font in the bottom-right corner of the page, whereas the Superior Court paginated the Clerk's Papers in the bottom-center of the page, without the "CP" and not in bold font. This petition, like the merits briefing on appeal, cites to the Superior Court's pagination.

Tacoma-based employees traveled to SIP's customers outside Tacoma to perform SIP's services on a transitory basis, and next-to-none of SIP's customers received services in Tacoma. CP 613-15.

SIP provided its services through approximately 1,000 general and administrative employees, who worked in approximately 42 states. CP 115, 235. Approximately 700 of the 1,000 employees worked outside of Tacoma, although that number fluctuated over time. CP 354-56. The approximately 300 employees working in Tacoma were accounted for in SIP's "payroll factor," which comprises half of the statutory apportionment formula and ranged from approximately one-quarter (26.38 percent) to approximately one-half (50.86 percent). CP 121-22.

SIP was contractually obligated to provide all managerial and administrative services required for the operation of its customers' medical practices. CP 114, 234. In-person interactions between SIP and its customers comprised a major

component of SIP's services. Those physical customer contacts occurred in the following settings:

- Providing training and development for customers' employees at regional and national conferences throughout the country;
- Serving as "hospital liaisons" at hospitals and skilled nursing facilities where the medical practices provided services; and
- Onboarding new physician hires by medical practices in major cities.

CP 115-16, 236-38.

Customer contact rarely occurred in Tacoma. CP 115-18, 236-38. None of the 66 medical practices were in Tacoma, and until 2016, none of the medical practices provided services in Tacoma. CP 114. In the second quarter of 2016, one of the medical practices began serving two Tacoma facilities, and a few of SIP's customers' employees were assigned to those facilities. CP 114, 235. That continued in 2017, but otherwise

neither SIP's customers (medical practices) nor its customers' customers (hospitals and nursing facilities) were in Tacoma. Six of the 92 training events, and none of the national conferences, took place in Tacoma. CP 237.

C. Procedural Background

In 2018, SIP discovered that it had overstated the proportion of its income from Tacoma, and thus overpaid B&O taxes to the City, for the years 2013 to 2017. CP 120-21. The City denied SIP's refund request and SIP appealed to the Hearing Examiner, requesting a refund of $964,766. CP 121. The Hearing Examiner ruled for the City. CP 650-65.

SIP filed a writ of review in Pierce County Superior Court under RCW 7.16.120. The Superior Court reversed the Hearing Examiner's decision. Adhering to Division One's statutory construction in *Wedbush Securities, Inc. v. City of Seattle*, 189 Wn. App. 360, 358 P.3d 422 (2015), the Superior Court held that RCW 35.102.130(3)(b) is a cascading hierarchy. RP 24-25. Because SIP has physical contact with its customers,

clause (i) applied to the exclusion of clauses (ii) and (iii), and the Superior Court reversed the Department's application of clause (ii). *Id.* at 25.

The City appealed, and the Court of Appeals (Division Two) reversed. *See generally* Op. The Court of Appeals rejected both SIP's position that Division One and the Superior Court correctly construed the clauses as a cascading hierarchy, and the City's position that the clauses are pure alternatives. Instead, the Court construed the clauses as alternatives "that the legislature intended should be selected based on which alternative most fairly apportions service income." *Id.* at 10. The Court of Appeals also held that SIP is not "taxable in the customer location[s]" outside of Tacoma because the state legislatures for the other jurisdictions—though they had the constitutional authority to tax SIP—had not "explicitly authorized imposition of a gross receipts tax." *Id.* at 11. Finally, the Court of Appeals held that its decision and Tacoma's apportionment of SIP's income comport with the Commerce

Clause because they "would not result in multiple taxation" and "reflect a reasonable sense of how income is generated." *Id.* at 12, 13.

V. ARGUMENT

This Court should accept review because the Court of Appeals' decision raises serious questions under the United States Constitution, misconstrues Washington law in a manner irreconcilable with a Division One decision construing the same statute, and causes significant, untenable practical challenges for taxpayers and taxing jurisdictions.

Each of those flaws warrants resolution by this Court. Taxing jurisdictions and taxpayers alike deserve clarity and constitutionality.

A. Tacoma's 233 percent increase of the total apportionment factor as compared to SIP's actual Tacoma service income raises significant questions under the United States Constitution.

Neither SIP nor the City advocated the interpretation of Washington's B&O tax scheme reached by the Court of

Appeals. *See* Op. at 12-13.[4] Independently construing the statute was the Court's prerogative, but unaided by the adversarial process, the Court of Appeals erred: its terse constitutional analysis of its novel interpretation misapplies settled law.

1. Tacoma's apportionment violates the Commerce Clause.

"The federal constitution's commerce clause—preserving to Congress the authority to regulate interstate commerce—may, by negative implication, render a local tax regulation unconstitutional if the regulation has the effect of burdening interstate commerce with the risk of multiple taxation." *Avanade, Inc. v. City of Seattle*, 151 Wn. App. 290, 301, 211 P.3d 476 (2009). Courts determine whether a tax is fairly

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[4] The Court of Appeals' effort to reconcile its construction with the City's position only confirms that it was charting its own course. Op. at 8 n.5. Even in the excerpts of briefing quoted by the Court, the City advocated discretion to choose between the three methods—not the nebulous "most fair" standard announced by the Court of Appeals.

apportioned by examining whether it is "externally" and "internally" consistent. *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989).

The Court of Appeals' interpretation fails the external consistency test. Boiled down, that inquiry asks whether the taxing jurisdiction is receiving more than its fair share. More specifically, "[t]he external consistency test asks whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *KMS Fin. Servs., Inc. v. City of Seattle*, 135 Wn. App. 489, 504, 146 P.3d 1195 (2006) (quoting *Goldberg*, 488 U.S. at 261). Apportionment fails the external consistency test when it is "out of all appropriate proportion to the business transacted" in the taxing jurisdiction. *Id.* at 505 (quoting *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931)). That is the case here.

The Supreme Court has prescribed how to determine the distortive effect of a single factor in a multi-factor

apportionment formula: by "comparing the percentage differences between the application of different methodologies." Hellerstein, *State Taxation* ¶ 8.16[5]. Most of SIP's activity for which it earned its fees from its customers occurred outside Tacoma. CP 613-14. The proportion of SIP's payroll in Tacoma never exceeded 51 percent, CP 121-22, and SIP had next-to-no customers in Tacoma. CP 114-18, 235-38. The City concedes that "not all of SIP's service income was generated in Tacoma." Opening Br. at 6. Yet it deemed 100 percent of SIP's service income "in the city," which caused more than 60 percent (and as much as 75 percent) of SIP's income to be apportioned to Tacoma every year at issue. CP 229.

The City's apportionment is unconstitutionally distortive as compared to SIP's actual service income in Tacoma. In no way does apportioning to Tacoma three-fifths to three-quarters of SIP's income "reasonably reflect[] the in-[city] component of the activity being taxed" or "a reasonable sense of how income

is generated." *City of Seattle v. KMS Fin. Servs., Inc.*, 12 Wn. App. 2d 491, 502-03, 459 P.3d 359 (2020) (*KMS II*) (internal quotation marks and citation omitted). SIP's actual service income in Tacoma was $8,756,516 for 2017; $5,204,514 for 2016; and zero for the other years—making the City's overall apportionment increase 233 percent as compared to the use of SIP's actual Tacoma service income. CP 725.[5]

Several examples illustrate that the discrepancy here is unconstitutional:

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[5] The Court of Appeals was just wrong when it stated that SIP "failed to produce evidence" showing that its income-producing activity is performed outside the city. Op. at 13 n.6; *see* CP 114-23, 235-38, 613-15, 635 (declarations explaining the scope of income-producing activity in versus outside of Tacoma). Furthermore, it is statutorily incorrect to equate income-producing activity with a requirement to show costs by location. Finally, in addition to its declarations reflecting the extent of activity outside Tacoma, cited above, the declaration at CP 725 and the schedule attached thereto, at CP 728, calculated SIP's "revenues from Tacoma" and used "numbers already in the record" to compute "the percentage increase between the City of Tacoma's statutory method of apportionment using costs of performance . . . and the apportionment result under the statutory method but using SIP's actual revenues or service income." CP 725.

- "[T]he U.S. Supreme Court in [*Container Corp. of America v. California Franchise Tax Board*, 463 U.S. 159 (1983)] noted that 'the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc*.'"[6] Hellerstein, *State Taxation* ¶ 8.16[5].
- In another decision, the actual value of rolling stock in Missouri was only 3.16 percent whereas using the statutory method, the commission determined that 8.28 percent was located in Missouri, and the Court held that this 162 percent increase violated the Constitution.[7]

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[6] (80% - 21.7%) / 21.7% = 268%. *Hans Rees'*, 283 U.S. at 134.

[7] (8.28% - 3.16%) / 3.16% = 162%.

Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n, 390 U.S. 317 (1968).

- In *KMS II*, discussed above, there was a 267 percent increase. *KMS II*, No. 78946-5-I, 2018 WL 6834777, at *21 (Dec. 14, 2018) (Appellant's Brief).[8]

The Court of Appeals did not address those decisions or perform the analysis they require. Instead, it simply recited the factors used by the City to determine SIP's cost of performance and deemed them to "reflect a reasonable sense of how income is generated." Op. at 13. But SIP was engaged in business in at least 42 states. CP 115, 235. Deeming all of its service income in Tacoma does not reasonably reflect where and how SIP generated its income. Fair apportionment must assign income amongst the states in which the taxpayer does business—not just one state (and city). The external consistency test looks to outcome, not process, and here the 233 percent increase in the

[8] (55% - 15%) / 15% = 267%.

overall apportionment factor when using SIP's actual service income in Tacoma compared to the deemed service income used by Tacoma shows significant distortion. That disparity is unconstitutional.

In any event, the unconstitutional outcome flows directly from the City's process. Tacoma ignored SIP's income-generating activity outside Tacoma and its customers' locations outside Tacoma, and effectively just double-counted SIP's substantial payroll expenses.[9] It then took an all-or-nothing approach, deciding that because more of SIP's costs are incurred in Tacoma than in any other single jurisdiction—even though the proportion is undisputedly less than half, CP 114-23, 235-38, 613-15, 635, —*every* dollar of service income

[9] The double counting occurs because payroll, which is already accounted for in the payroll factor, constituted more than 90 percent of the costs of performance that the City used to deem service income in Tacoma when calculating the service income factor. CP 231, 548-49; *see also* Opening Br. at 15 (conceding that "direct labor costs" are one component of "costs of performance").

generated *anywhere* is deemed in Tacoma. That is unconstitutional as applied to SIP, and to any other taxpayer with a geographically broad footprint.

It can hardly be called apportionment, particularly for geographically dispersed taxpayers, to allocate 100 percent of service income to whatever jurisdiction hosts a bare plurality of the taxpayer's costs. It should come as little surprise, then, that courts reject all-or-nothing apportionment. The Tennessee Supreme Court, for instance, agreed that an all-or-nothing method is an unreasonable approach to allocating business activity because it does not fairly reflect business activity in Tennessee. *Vodafone Americas Holdings, Inc. & Subsidiaries v. Roberts*, 486 S.W.3d 496, 526-27 (Tenn. 2016); *see also Corp. Exec. Bd. Co. v. Va. Dep't of Tax'n*, 297 Va. 57, 66, 822 S.E.2d 918 (2019) (noting that the all-or-nothing, costs of performance method of apportionment "has faced mounting criticism" and was adopted "against the backdrop of an economy dominated

by mercantile and manufacturing enterprises" (internal quotation marks and citation omitted)).

The Tennessee Supreme Court, like other courts, framed its analysis in terms of fairness rather than constitutionality because the party seeking the adjustment was the taxing jurisdiction and it sought adjustment as a statutory rather than constitutional right. Courts find the all-or-nothing approach unfair for the same reason it is unconstitutional here: it would allocate all of the taxpayer's service income to a single jurisdiction.[10]

That is where the leading treatise on state taxation has observed that "when the services [at issue] involve the expenditure of substantial amounts of time or costs in more than one state," the all-or-nothing approach "often produces capricious and inequitable results." Hellerstein, *State Taxation*

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[10] Similarly, an unconstitutionally distortive apportionment provision also fails to fairly reflect the taxpayer's activity, requiring adjustment pursuant to RCW 35.102.130(3)(d).

¶ 9.18[3][a]. Here, the all-or-nothing approach was unconstitutionally distortive.

2. The Court of Appeals' construction of the balance of the statute exacerbates the constitutional problem.

The unconstitutional disparity arises not because SIP's business is idiosyncratic, but because of the gloss the Court of Appeals placed on the statute, which replicates the problem as to countless geographically dispersed taxpayers.

When apportioning service income, clauses (ii) and (iii) can apply only if the taxpayer is "not taxable [in/at] the customer location." RCW 35.102.130(3)(b). According to the Court of Appeals, "taxable" refers to legislative, not constitutional, authority: "the applicable legislature must have *explicitly authorized* imposition of a gross receipts tax." Op. at 11 (emphasis added). That was an interpretive error that compounded the constitutional problem.

The Supreme Court has squarely rejected the notion that the constitutionality of a state tax should "depend on the

vagaries of [another state's] tax policy." *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 444 (1980). The lower courts relied on the fact that New York "d[id] not presently tax the dividends in question," so "actual multiple taxation [wa]s not demonstrated," but the Court found that irrelevant to the analysis. *Id.* Because the other states in which SIP conducts business "had constitutional nexus to tax," the "accompanying risk of taxation can fuel a Commerce Clause challenge." *PopularCategories.Com, Inc. v. Gerregano*, No. M2017-01382-COA-R3-CV, 2018 WL 6720664, at *10 (Tenn. Ct. App. Dec. 20, 2018) (citing *Mobil Oil*, 445 U.S. at 444). The Court of Appeals erred in holding otherwise.

Moreover, the Court of Appeals' interpretation misses the point of the provision it construed: avoiding a claim to income that another jurisdiction can also claim, and thereby avoid the external inconsistency problem discussed above. Under the Court of Appeals' interpretation, geographically dispersed taxpayers would rarely be taxable at customer

locations outside of Tacoma. And with the "not taxable at the customer location" limitation neutered of practical effect, the methods under clauses (ii) and (iii) will almost always be available methods of apportionment, resulting in Tacoma asserting taxation over more than its fair share.

The Court of Appeals' only explanation for its interpretation is that reading "taxable in the customer location" to refer to that jurisdiction's *constitutional* authority to tax would render the language superfluous "because every taxing jurisdiction in the country has the constitutional authority to tax gross receipts." Op. at 11. That may be accurate today, but it was not true in 2008 when the legislature enacted the language at issue. Until 2018, it was generally understood that *physical* presence in a jurisdiction remained a prerequisite to establish the constitutionally required "substantial nexus" for taxation. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 311-17 (1992) (explaining the physical presence requirement); *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2092-96 (2018) (holding that

even absent a physical footprint, economic presence can form the requisite nexus to constitutionally impose a tax). When the constitutional authority to tax required physical presence, that limitation was far from superfluous. Because the presumption against superfluity is intended to discern legislative intent, it was misguided to apply it based on the legal landscape today rather than 2008.

In fact, it is the Court of Appeals' interpretation—again, one not advocated by the City or addressed in the parties' briefing—that creates superfluity. As construed by the Court of Appeals, a taxpayer is taxable at the customer location if (1) it is *actually* subject to a gross receipt tax in the customer location, or (2) the applicable legislature has explicitly *authorized* imposition of a gross receipts tax. *See* RCW 35.102.130(4)(h); Op. at 11. Alternative (2) completely subsumes alternative (1): any jurisdiction "subject[ing]" a taxpayer to a gross receipts tax was necessarily "authori[zed]"

to impose that tax. That implication further shows that the Court of Appeals misconstrued the statute.

With clause (ii) plagued by the all-or-nothing problem described above, and clauses (ii) and (iii) lacking any meaningful limitation on their applicability, it will take an unusual case for Washington's apportionment method to pass constitutional muster as applied to a geographically dispersed taxpayer. The result here should have been no different than in the constitutional precedent discussed above. The 233 percent increase between the use of SIP's actual service income in Tacoma and its revenue deemed in Tacoma fails the external consistency test and violates the Constitution.

This Court should accept review to remedy the constitutional wrong and clarify the misguided constitutional and statutory analysis that led the Court of Appeals to err.

B. The decision misconstrues the statute, conflicts with a published decision by Division One, and causes practical problems of substantial public importance.

The constitutional problems discussed above stem from the Court of Appeals' misinterpretation of the core statutory text. The Court held that the three clauses of RCW 35.102.130(3)(b) are "a set of equal alternatives that the legislature intended should be selected based on which alternative most fairly apportions service income." Op. at 10. That "most fair" standard lacks any textual basis and provides no guidance or guardrails for the subjective equitable inquiry it prescribes. That real-world problem also warrants correction.

The best construction of the statute, considering text, constitutional bounds, precedent, and practicality, is as a cascading hierarchy where one starts with the first prong, and moves down each prong until one applies, but where only one prong can apply to each customer.[11] Each prong is written with

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[11] The analysis is performed on a customer-by-customer basis. Receipts from some customers could be assigned to

conditions—meaningful guardrails—so that only one should apply. It is easy to apply consistently and constitutionally.

For example, if the majority of physical contacts for a customer occur in Tacoma, those receipts are assigned to Tacoma under clause (i) and the analysis stops there for that customer. If there are no contacts in Tacoma for that customer, then the analysis moves to clause (ii). If there are no contacts in Tacoma after applying clause (i) and the taxpayer is taxable at the customer's location when applying clauses (ii) and (iii), then no revenues are assigned to Tacoma.

In practical operation, if there are no physical contacts, as in *Wedbush*, then (ii) or (iii) will apply. 189 Wn. App. at 365. For one of SIP's customers, SIP could not establish whether there were any contacts, so SIP deemed that customer's receipts to be in Tacoma. CP 123 (¶ 63). For each of its other customers, SIP established that none of the contacts occurred in Tacoma

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Tacoma and receipts from other customers could be assigned elsewhere.

and that a majority occurred outside Tacoma. Because meeting with and performing services through employees in a taxing jurisdiction gives that taxing jurisdiction the constitutional authority to impose a tax, whether or not the jurisdiction has enacted such a tax, clauses (ii) and (iii) cannot apply, and no additional service income is in Tacoma.

That was Division One's conclusion with respect to the service income factor: the clauses are "cascading," and "clauses (ii) or (iii) come into play" only "[i]f there are no [physical customer] contacts." *Wedbush*, 189 Wn. App. at 365. Following *Wedbush* would have avoided constitutional problems, practical problems, and the inter-division split of authority.[12] The Court of Appeals tries to reconcile its decision with *Wedbush*, Op. at 10, but the insignificant contextual distinction it makes does

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[12] The balance of the Court's textual analysis, Op. at 7-9, ignores that the statute applies on a per-customer basis. *See supra* note 11. So, for customers that SIP interacts with in Tacoma, clause (i) applies, and for customers SIP interacts with elsewhere, clauses (ii) or (iii) can apply.

not change the facts that (1) Division One construed the statute as a cascading hierarchy, and (2) that determination was integral to the outcome. *Wedbush*, 189 Wn. App. at 365.

Clearly defined statutory standards and structure—such as the cascading hierarchy with statutorily defined terms that SIP advocated—are especially important in the tax context. Taxpayers voluntarily assess and pay their own taxes in the first instance, and most of them are never audited by the taxing jurisdiction.[13] The decision leaves it to taxpayers to decide which of the clauses "most fairly" apportions their income. Op. at 10. Little wonder that the City never advocated that standard: it is far too subjective and nebulous to be consistently and fairly applied by taxpayers. And as this case shows, it is frequently unconstitutional when applied by taxing jurisdictions.

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[13] *See, e.g.*, Internal Revenue Service, *The Tax Gap* (updated Nov. 2, 2021), https://www.irs.gov/newsroom/the-tax-gap.

To the extent the statute is ambiguous, avoiding those constitutional problems and impracticalities should have steered the Court of Appeals away from the construction it settled on. But because the "most fair" standard came from neither statutory text nor the parties' briefing, the Court of Appeals lacked input from the parties on those points. Unguided by the adversarial process, the Court of Appeals invented a rudderless standard, untethered to the text, which compounds rather than avoids the constitutional and practical problems. Empowering each jurisdiction to determine which method of apportionment is "most fair," without any principled limitations on that subjective inquiry, inevitably leads to the risks of one jurisdiction asserting claim to more than its fair share and multiple taxation that the Commerce Clause protects against.

In short, the decision is fundamentally unfair to everyone involved. It is unfair to taxing jurisdictions and their citizens, which will be deprived of tax revenue by self-interested taxpayers assessing what they subjectively deem "most fair." It

is unfair to well-meaning taxpayers, which despite their best efforts can have little confidence that their assessment of what is "most fair" will correspond with what the taxing jurisdiction might decide in an audit. And it is unfair to the courts, which will be left adjudicating countless challenges to what is "most fair." Nobody wins.

Construing the statute in a principled, easily applied manner where only one prong can apply in each circumstance avoids the discretion and uncertainty inherent in the Court of Appeals' decision. It also avoids the constitutional infirmity and inequity that manifested here and will do so in countless cases to come. This Court should accept review to assess those arguments and correct the Court of Appeals' errors of constitutional law and statutory construction.

VI. CONCLUSION

SIP respectfully requests that the Court accept review of the Court of Appeals' decision.

RESPECTFULLY SUBMITTED this 5th day of May, 2022.

This document contains 4,788 words, excluding the parts of the document exempted from the word count by RAP 18.17(b), and complies with the applicable word-count limit set forth in RAP 18.17(c).

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APPENDIX

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Division Two

April 5, 2022

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

SOUND INPATIENT PHYSICIANS, INC., a Delaware Corporation, Appellant, v. CITY OF TACOMA, a Washington Municipal Corporation, through its Finance Department, Tax & License Division, and CITY OF TACOMA OFFICE OF THE HEARING EXAMINER, Respondent.	No. 55391-1-II PUBLISHED OPINION

PRICE, J. — The city of Tacoma (City) appeals the superior court's order reversing the city of Tacoma's hearing examiner's order that denied Sound Inpatient Physicians, Inc.'s (SIP) request for a refund for alleged overpaid business and occupation (B&O) taxes. As the party bearing the burden of proving that the tax assessment was improper, SIP argues that the City misinterpreted the applicable statutory language and erroneously apportioned the amount of SIP's service income to the City. And SIP argues that if the City's interpretation of the applicable statute is correct, then the statute violates the federal commerce clause.[1] We reverse the superior court's order in favor of SIP and affirm the hearing examiner.

[1] U.S. CONST. art. I, § 8, cl. 3.

FACTS

SIP is a company providing management and administrative services to medical professionals. These services are performed in Tacoma and other locations across the country. SIP has three major offices in Tacoma, Tennessee, and Texas. SIP has 14 other regional offices and many employees work from home.

In 2019, the City's finance department completed an audit of SIP's B&O taxes for 2013-2017. The audit was performed to determine whether SIP correctly apportioned the taxes on its gross receipts. Tax apportionment was determined based on a payroll factor and a service income factor. The City agreed with SIP's method for calculating the payroll factor.

However, the City rejected SIP's calculation of the service income factor. SIP calculated the service income factor based exclusively on customer contacts that occurred within the city—which were nearly zero. The City, on the other hand, determined that because the majority of SIP's business services (coding, billing, collections, claims, record-keeping, etc.) did not require any direct customer contact, apportionment based on customer contacts did not reflect a fair apportionment of service income. Therefore, the City determined that the service income factor should be determined using the costs of performance.

The City used four factors to calculate the costs of performance: "1) direct labor costs, 2) facility lease expense, 3) facility other expense, and 4) depreciation." Clerk's Papers (CP) at 61. Using these factors, the City determined that "the majority of expenses that are trackable by a location[] occur in Tacoma, and therefore all revenue is to be allocated to Tacoma because every expense item . . . used for the [cost of performance] calculation has a higher expense percentage in Tacoma compared to any other single location of SIP." CP at 61 (emphasis omitted). The City

also noted that only 5 of the 50 states have gross receipts taxes and, therefore, SIP's Texas and Tennessee offices have not paid any gross receipts taxes.

Based on the audit, the City assessed an additional $134,096 in B&O taxes against SIP. SIP appealed the City's decision to the hearing examiner arguing that the City's tax assessment incorrectly determined the service income factor. SIP sought a refund of $805,022 for taxes it believed it overpaid based on its calculation of the service income factor. The parties filed cross-motions for summary judgment. The hearing examiner granted the City's motion for summary judgment and denied SIP's request for a refund.

SIP filed a writ of review to appeal the matter to superior court. The superior court reversed the hearing examiner's order on the parties' cross-motions for summary judgment and granted SIP's request for a refund.

The City appeals the superior court's order.

ANALYSIS

SIP successfully argued to the superior court that the hearing examiner erred by granting the City's motion for summary judgment and summary judgment should, instead, be entered in its favor. On appeal, SIP renews its argument that statutory construction does not support the City's calculation of its tax burden. Further, SIP renews its argument that the City's calculation of its tax burden is unconstitutional because it violates the federal commerce clause. We disagree with SIP.

I. LEGAL PRINCIPLES

Because this case was resolved on cross-motions for summary judgment, we review the superior court's decision reversing the hearing examiner de novo. *City of Seattle v. KMS Fin. Services, Inc.*, 12 Wn. App. 2d 491, 501, 459 P.3d 359 (2020). The taxpayer bears the burden of

proving that a tax paid is incorrect. RCW 34.05.570**(**a); *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 41, 156 P.3d 185 (2007). " '[T]axes are presumed to be just and legal, and the burden rests upon one assailing the tax to show its invalidity.' " *Id.* (quoting 72 AM. JUR. 2D *State and Local Taxation* § 1000 (2006)).

Statutory construction is an issue of law that we review de novo.[2] *Id.* Our goal is to give effect to the legislature's purpose and intent. *Jametsky v. Olsen*, 179 Wn.2d 756, 762, 317 P.3d 1003 (2014). "Where a statute is clear on its face, its plain meaning should 'be derived from the language of the statute alone.' " *Ford Motor Co.*, 160 Wn.2d at 41 (quoting *Kilian v. Atkinson*, 147 Wn.2d 16, 20, 50 P.3d 638 (2002)). If the plain language of the statute is unambiguous, we do not resort to canons of judicial constructions. *Jamestsky*, 179 Wn.2d at 762. A statute is only ambiguous if it is subject to more than one reasonable interpretation. *Id.*

In construing a statute, we avoid interpretations that render portions of a statute meaningless or superfluous. *Ford Motor Co.*, 160 Wn.2d at 41. We must also avoid constructions that yield unlikely, absurd, or strained consequences. *Thurston County ex rel. Snaza v. City of Olympia*, 193 Wn.2d 102, 108, 440 P.3d 988 (2019). "However, when construing an ordinance, a 'reviewing court gives considerable deference to the construction of' the challenged ordinance 'by those officials charged with its enforcement.' " *Ford Motor Co.*, 160 Wn.2d at 42 (quoting *Gen. Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 57, 25 P.3d 1022 (2001)).

[2] The City ordinance that governed the allocation at issue here is former Tacoma Municipal Code (TMC) 6A.30.077(F) (2018). The language of TMC 6A.30.077(F) is the same as former RCW 35.102.130(3) (2017). And municipal ordinances are construed according to the rules of statutory construction. *Ford Motor Co.*, 160 Wn.2d at 41. Accordingly, we interpret the language of former RCW 35.102.130(3).

We also review constitutional issues de novo. *Amunrud v. Bd. of Appeals*, 158 Wn.2d 208, 215, 143 P.3d 571 (2006), *abrogated on other grounds by Yim v. City of Seattle*, 194 Wn.2d 682, 689-90, 451 P.3d 694 (2019). "[T]he burden to show unconstitutionality is on the challenger." *Id.*

II. STATUTORY CONSTRUCTION

SIP argues that the City has improperly interpreted how to calculate its tax liability under former RCW 35.102.130(3)(b) (2017).[3] Specifically, SIP argues that Division One's opinion in *Wedbush*[4] requires the statute be interpreted as "cascading hierarchy" and, because SIP had negligible customer locations within the city, essentially no tax liability for service income can be apportioned to SIP under the statute. Br. of Resp't at 14 (boldface omitted). Alternatively, SIP argues that even if the statute's alternatives are not "cascading," the City still improperly applied the statute to SIP because it is taxable at the customer locations. We disagree with SIP's arguments and hold that the City properly interpreted the statutory language.

B&O taxes are assessed for the privilege of conducting business in a taxing jurisdiction. *Ford Motor Co.*, 160 Wn.2d at 44. Apportionment of B&O taxes is determined under former RCW 35.102.130. When business is conducted in various locations, income must be apportioned to reflect the location in which it is earned. *KMS*, 12 Wn. App. 2d at 502. "The tax must actually reflect a reasonable sense of how income is generated." *Id.* at 502-03.

[3] The parties agree that the 2017 version of RCW 35.102.130 applies to this case. The 2017 version RCW 35.102.130 was amended to change the way service income is apportioned. LAWS OF 2019, ch. 101, § 1.

[4] *Wedbush Sec., Inc. v. City of Seattle*, 189 Wn. App. 360, 358 P.3d 422 (2015).

Gross income from services is taxed by the City based on "multiplying apportionable income by a fraction, the numerator of which is the payroll factor plus the service-income factor and the denominator of which is two." Former RCW 35.102.130(3). The parties dispute only the calculation of the service income factor.

The service income factor reflects the proportion of service income earned in the city as compared with other locations. Former RCW 35.102.130(3)(b). The statute defines the service income factor as follows:

> The service income factor is a fraction, the numerator of which is the total service income of the taxpayer in the city during the tax period, and the denominator of which is the total service income of the taxpayer everywhere during the tax period.

Former RCW 35.102.130(3)(b).

Subsection (3)(b)(i) provides that service income is in the city if "[t]he customer location is in the city[.]" Under subsection (b)(ii) service income is in the city if "[t]he 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[.]" And subsection (b)(iii) provides service income is in the city if "[t]he service-income-producing activity is performed within the city, and the taxpayer is not taxable in the customer location." The subsections of former RCW 35.102.130(3)(b) are separated by the disjunctive "or."

"Customer location" means "the city or unincorporated area of a county where the majority of the contacts between the taxpayer and the customer take place." Former RCW 35.102.130(4)(d). "Taxable in the customer location" means "either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the

government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so." Former RCW 35.102.130(4)(h).

A. DETERMINING WHICH PROVISION OF FORMER RCW 35.102.130(3)(b) APPLIES

SIP argues that former RCW 35.102.130(3)(b) must be read as a cascading hierarchy of apportionment methods and does not allow the City to choose which provision of former RCW 35.102.130(3)(b) should be used to determine the amount of apportioned service income. SIP asserts that as a cascading hierarchy, the City may apply subsection (b)(ii) or subsection (b)(iii) only if subsection (b)(i) does not apply. SIP argues that because it has customer contacts, it can establish customer locations. And because those customer locations are outside of the city, subsection (b)(i) applies and its service income cannot be apportioned to the City. We disagree.

First, SIP's cascading hierarchy argument makes the relevant factual question whether SIP can establish any customer location, either inside or outside the city, through any physical contact with customers. If so, under SIP's reading of the statute, the City may only apportion service income based on subsection (b)(i). This interpretation is not consistent with the plain language of the statute, renders portions of the statute meaningless, and leads to an absurd result.

The plain language of former RCW 35.102.130(3)(b) simply does not support SIP's interpretation as a cascading hierarchy. Instead, former RCW 35.102.130(3)(b) should be read to provide three alternative methods of apportioning, allowing the taxing authority to select the

method that most fairly and accurately apportions income.[5] Contrary to SIP's assertion, subsection (b)(i) does not prohibit apportionment when a customer location is outside the city, it is silent on what happens if the customer location is not in the city. In fact, there is no language in former RCW 35.102.130(3)(b) that requires the provisions to be applied in any specific manner.

And SIP's construction of this subsection is not a reasonable interpretation of the statute's plain language. Using cost of performance to determine apportioned service income specifically *because* customer locations are outside the city allows the City to fairly apportion income that is generated by services performed in the city for customers outside the city. Accordingly, the plain language of subsection (b)(i) does not support SIP's interpretation that when a business has physical contacts with customers—establishing customer locations—service income can only be apportioned based on customer locations within the city. Interpreting subsection (b)(i) to prohibit any apportionment of service income when customer locations are identified outside of the city is not consistent with the legislature's intent to fairly apportion service income generated in the city.

In addition, the plain language of subsection (b)(ii) and subsection (b)(iii) contain language that specifically accounts for the customer location being outside of the city. Both provisions only apply if "the taxpayer is not taxable [at/in] the customer location." Accordingly, SIP's position that subsection (b)(ii) and subsection (b)(iii) can only apply when there is no customer location is

[5] This interpretation is consistent with the City's interpretation of the statute. The City argues that the legislature has provided a list of alternatives that must be used "to determine which specific provision fairly fits a given situation." Appellant's Opening Br. at 18. And the City asserts that the provisions of the statute "ensure a balanced and fair approach by requiring that tax administrators and taxpayers review every provision to determine which provision fairly apportions the taxpayer's service income." Appellant's Opening Br. at 20. The City does not argue for an unqualified or arbitrary discretion to choose whichever method it wants to apply.

inconsistent with the statutory language. The plain language of the two subsections establishes a basis for the factor even when there is a customer location and that customer location is outside of the city. Therefore, interpreting former RCW 35.102.130(3)(b) to provide equal alternatives that must be selected based on which alternative provides the most fair apportionment of service income is the most reasonable and most accurately effectuates the legislature's intent to fairly apportion income.

Further, if we accepted SIP's interpretation, then subsection (b)(ii) and subsection (b)(iii) would only apply if there was no identifiable customer location. But in that case, there would be no customer location at all so the language "not taxable at the customer location" could not apply. SIP's interpretation would render this language superfluous or meaningless, and we avoid such interpretations.

Finally, SIP's interpretation creates an absurd result that does not account for the reality that businesses can generate service income through a variety of methods. SIP does have some contact with customers but as the City identified, SIP's service income is primarily derived from services that do not require physical contact with customers. SIP's service income is derived from services performed at its office without any physical contact with customers. The purpose of tax apportionment is to fairly identify and apportion the amount of income that is generated within the city. *KMS*, 12 Wn. App. 2d at 502-03. Allowing a business to avoid apportioning any service income to a city simply because it can establish that it has made some physical contacts with customers, even if those contacts are incidental to the bulk of the service income generating activity, is absurd and could not have been what the legislature intended when it designed this scheme to fairly apportion service income.

Despite this reasonable interpretation of former RCW 35.102.130(3)(b), SIP relies extensively on Division One's opinion in *Wedbush*, to argue that the statute dictates a strict cascading hierarchy. Decisions of other divisions are persuasive authority and are not binding. *In re Pers. Restraint of Arnold*, 190 Wn.2d 136, 150-52, 154, 410 P.3d 1133 (2018). In *Wedbush*, the court stated:

> RCW 35.102.130 has cascading clauses to determine whether the service income is in the city. The first clause to determine service income (i) provides contacts as the determining factor of income. If there are no contacts, then clauses (ii) or (iii) come into play.

189 Wn. App. at 365. Our opinion is not inconsistent with Division One's holding. Although Division One stated that the other clauses apply if there are no contacts, Division One was addressing a situation in which the "majority of contact with customers occurs through the telephone and the Internet." *Id*. at 362. That case was primarily addressing whether customer locations were determined by physical contacts or any contacts. *Id*. at 364-65. Because the court was not addressing whether isolated physical contacts prevented the City from being able to apportion service income in the city, the opinion has limited persuasive value on the issues being decided here.

We interpret former RCW 35.102.130(3)(b) as a set of equal alternatives that the legislature intended should be selected based on which alternative most fairly apportions service income. The City's audit was consistent with this interpretation when it considered the different alternative methods in former RCW 35.102.130(3)(b) and chose the method that most fairly apportioned SIP's service income to the City.

B. INTERPRETATION OF "TAXABLE AT THE CUSTOMER LOCATION" LANGUAGE

SIP also argues that even if subsection (3)(b)(ii) applies, the language regarding "not taxable at the customer location" should be interpreted to mean the customer location has the *constitutional* authority to tax rather than the *legislative* authority to tax. SIP argues that because all of the locations where it operates have the constitutional authority to impose a gross receipts tax, SIP is "taxable" at the customer locations and, therefore, service income cannot be apportioned to the City. We disagree.

The statute defines "taxable in the customer location" as "either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so." Former RCW 35.102.130(4)(h).

Here, relying on only constitutional authority to tax, as urged by SIP, renders the provision meaningless. If "authority" meant constitutional authority, the "not taxable" clauses in subsection (b)(ii) and subsection (b)(iii) would be meaningless because every taxing jurisdiction in the country has the constitutional authority to tax gross receipts. Instead, we interpret the language in subsection (b)(ii) and subsection (b)(iii) to mean that the applicable legislature must have explicitly authorized imposition of a gross receipts tax.

The City properly interpreted subsection (b)(ii) to mean there must be an explicitly authorized gross receipt tax at the customer location. Therefore, the hearing examiner properly granted summary judgment in favor of the City and the superior court erred by reversing the hearing examiner's order.

III. CONSTITUTIONALITY

Finally, SIP argues that the City's application of former RCW 35.102.130(3)(b) violates the federal commerce clause because the tax was not fairly apportioned. Under the commerce clause a tax on interstate commerce is constitutionally permissible if: (1) the taxpayer has a substantial nexus with the taxing jurisdiction, (2) the tax does not discriminate against interstate commerce, (3) the tax is fairly apportioned, and (4) there is a reasonable relationship between the tax imposed upon the taxpayer and the services provided by the taxing jurisdiction. *KMS*, 135 Wn. App. at 504. A tax is fairly apportioned if it is internally and externally consistent. *Id.*

A. INTERNAL CONSISTENCY

SIP argues that the City's apportionment of its tax liability is not internally consistent. We disagree.

"Internal consistency requires a tax to be 'structured so that if every State were to impose an identical tax, no multiple taxation would result.' " *KMS*, 135 Wn. App. at 504 (quoting *Goldberg v. Sweet*, 488 U.S. 252, 261, 109 S. Ct. 582, 102 L. Ed. 2d 607 (1989)).

Here, the City's tax apportionment would not result in multiple taxation because the cost of performance apportionment can only be used if the business is not taxable at the customer location. Assuming every state imposed such a scheme, no business could be subject to multiple taxation because the "not taxable at the customer location" language ensures that the business is only subject to a single gross receipts tax. Because the City's tax apportionment ensures that the business is only taxed in one location, no multiple taxation can result, making it internally consistent.

B. EXTERNAL CONSISTENCY

SIP also argues that the costs of performance method as applied is not externally consistent. We disagree.

External consistency requires that " 'the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.' " *Id.* at 505 (quoting *Container Corp. of Am. v. Cal. Franchise Tax Bd.*, 463 U.S. 159, 169, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983)).

Here, the City used four factors to determine SIP's cost of performance: 1) direct labor costs, 2) facility lease expense, 3) facility other expense, and 4) depreciation. These four factors reflect a reasonable sense of how SIP's income is generated because it is reasonable to determine that the cost of performance is directly correlated with the amount of income generated by a company. And labor costs combined with expenses is a reasonable method of calculating cost of performance. Therefore, the City's cost of performance factors reflect a reasonable sense of how income is generated and the tax apportionment is externally consistent.[6]

The City's tax apportionment does not violate the commerce clause because it is both internally and externally consistent. Therefore, SIP's constitutional challenge to the City's tax apportionment fails.

[6] To the extent that SIP argues that the City's cost of performance factors are externally inconsistent as it is applied to their business, this argument fails. The City calculated the cost of performance based on information that SIP provided and reached its 100 percent determination primarily based on SIP's failure to track expenses by location. Because SIP has failed to produce evidence showing that its costs of performance and resulting income producing activity are performed in a greater proportion outside of the city, it cannot meet its burden to show that the city's tax apportionment is externally inconsistent as applied to its business.

CONCLUSION

We hold that former RCW 35.102.130(3)(b) provides equal alternatives for determining a taxpayer's service income factor that must be selected based on which alternative provides the most fair apportionment of service income and not rigidly as a cascading hierarchy. We further hold that "not taxable at the customer location" as used in former RCW 35.102.130(3)(b)(ii) refers to legislative authority, not constitutional authority. And finally, we hold that former RCW 35.102.130(3)(b) does not violate the federal commerce clause. Accordingly, we reverse the superior court's order in favor of SIP and affirm the hearing examiner.

Price, J.

PRICE, J.

We concur:

Glasgow, CJ

GLASGOW, C.J.

J.

LEE, J.

ATTACHMENTS

RCW 35.102.130

Allocation and apportionment of income. *(Effective until January 1, 2020.)*

A city that imposes a business and occupation tax must provide for the allocation and apportionment of a person's gross income, other than persons subject to the provisions of chapter **82.14A** RCW, as follows:

(1) Gross income derived from all activities other than those taxed as service or royalties must be allocated to the location where the activity takes place.

(a) In the case of sales of tangible personal property, the activity takes place where delivery to the buyer occurs.

(b)(i) In the case of sales of digital products, the activity takes place where delivery to the buyer occurs. The delivery of digital products will be deemed to occur at:

(A) The seller's place of business if the purchaser receives the digital product at the seller's place of business;

(B) If not received at the seller's place of business, the location where the purchaser or the purchaser's donee, designated as such by the purchaser, receives the digital product, including the location indicated by instructions for delivery to the purchaser or donee, known to the seller;

(C) If the location where the purchaser or the purchaser's donee receives the digital product is not known, the purchaser's address maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith;

(D) If no address for the purchaser is maintained in the ordinary course of the seller's business, the purchaser's address obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith; and

(E) If no address for the purchaser is obtained during the consummation of the sale, the address where the digital good or digital code is first made available for transmission by the seller or the address from which the digital automated service or service described in RCW **82.04.050** (2)(g) or (6)(c) was provided, disregarding for these purposes any location that merely provided the digital transfer of the product sold.

(ii) If none of the methods in (b)(i) of this subsection (1) for determining where the delivery of digital products occurs are available after a good faith effort by the taxpayer to apply the methods provided in (b)(i)(A) through (E) of this subsection (1), then the city and the taxpayer may mutually agree to employ any other method to effectuate an equitable allocation of income from the sale of digital products. The taxpayer will be responsible for petitioning the city to use an alternative method under this subsection (1)(b)(ii). The city may employ an alternative method for allocating the income from the sale of digital products if the methods provided in (b)(i)(A) through (E) of this subsection (1) are not available and the taxpayer and the city are unable to mutually agree on an alternative method to effectuate an equitable allocation of income from the sale of digital products.

(iii) For purposes of this subsection (1)(b), the following definitions apply:

(A) "Digital automated services," "digital codes," and "digital goods" have the same meaning as in RCW **82.04.192**;

(B) "Digital products" means digital goods, digital codes, digital automated services, and the services described in RCW **82.04.050** (2)(g) and (6)(c); and

(C) "Receive" has the same meaning as in RCW **82.32.730**.

(c) If a business activity allocated under this subsection (1) takes place in more than one

city and all cities impose a gross receipts tax, a credit must be allowed as provided in RCW **35.102.060**; if not all of the cities impose a gross receipts tax, the affected cities must allow another credit or allocation system as they and the taxpayer agree.

(2) Gross income derived as royalties from the granting of intangible rights must be allocated to the commercial domicile of the taxpayer.

(3) Gross income derived from activities taxed as services shall be apportioned to a city by multiplying apportionable income by a fraction, the numerator of which is the payroll factor plus the service-income factor and the denominator of which is two.

(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the city during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period. 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 fifty percent 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 fifty percent or more of his or her service in any city, and the employee resides in the city.

(b) The service income factor is a fraction, the numerator of which is the total service income of the taxpayer in the city during the tax period, and the denominator of which is the total service income of the taxpayer everywhere during the tax period. 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.

(c) If the allocation and apportionment provisions of this subsection do not fairly represent the extent of the taxpayer's business activity in the city or cities in which the taxpayer does business, the taxpayer may petition for or the tax administrators may jointly require, in respect to all or any part of the taxpayer's business activity, that one of the following methods be used jointly by the cities to allocate or apportion gross income, if reasonable:

(i) Separate accounting;

(ii) The use of a single factor;

(iii) The inclusion of one or more additional factors that will fairly represent the taxpayer's business activity in the city; or

(iv) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(4) The definitions in this subsection apply throughout this section.

(a) "Apportionable income" means the gross income of the business taxable under the service classifications of a city's gross receipts tax, including income received from activities outside the city if the income would be taxable under the service classification if received from activities within the city, less any exemptions or deductions available.

(b) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid to individuals for personal services that are or would be included in the individual's gross income under the federal internal revenue code.

(c) "Individual" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee of that

taxpayer.

(d) "Customer location" means the city or unincorporated area of a county where the majority of the contacts between the taxpayer and the customer take place.

(e) "Primarily assigned" means the business location of the taxpayer where the individual performs his or her duties.

(f) "Service-taxable income" or "service income" means gross income of the business subject to tax under either the service or royalty classification.

(g) "Tax period" means the calendar year during which tax liability is accrued. If taxes are reported by a taxpayer on a basis more frequent than once per year, taxpayers shall calculate the factors for the previous calendar year for reporting in the current calendar year and correct the reporting for the previous year when the factors are calculated for that year, but not later than the end of the first quarter of the following year.

(h) "Taxable in the customer location" means either that a taxpayer is subject to a gross receipts tax in the customer location for the privilege of doing business, or that the government where the customer is located has the authority to subject the taxpayer to gross receipts tax regardless of whether, in fact, the government does so.

[2017 c 323 § 511; 2010 c 111 § 305; 2003 c 79 § 13.]

NOTES:

Tax preference performance statement exemption—Automatic expiration date exemption—2017 c 323: See note following RCW **82.04.040**.

Purpose—Retroactive application—Effective date—2010 c 111: See notes following RCW **82.04.050**.

Effective date—2003 c 79 § 13: "Section 13 of this act takes effect January 1, 2008." **[2003 c 79 § 19.]**

RCW 35.102.130

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(B) If not received at the seller's place of business, the location where the purchaser or the purchaser's donee, designated as such by the purchaser, receives the digital product, including the location indicated by instructions for delivery to the purchaser or donee, known to

CERTIFICATE OF SERVICE

On May 5, 2022, I caused to be served upon the below named counsel of record, at the address stated below, via the method of service indicated, a true and correct copy of the foregoing document.

Debra E. Casparian, WSBA No. 26354 Deputy City Attorney Tacoma City Attorney's Office 747 Market Street, Room 1120 Tacoma, WA 98402 dcasparian@cityoftacoma.org *Attorney for Respondents*	**X** Via the Appellate Court Web Portal ____ Via hand delivery ____ Via U.S. Mail, 1st Class, Postage Prepaid ____ Via Overnight Delivery ____ Via Facsimile **X** Via Email (Per E-Service Agreement)

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

EXECUTED at Seattle, Washington, on May 5, 2022.

/s June Starr
June Starr

PERKINS COIE LLP

May 05, 2022 - 11:30 AM

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