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**COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON**

LENDINGTREE, LLC,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

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I. INTRODUCTION

This case concerns the business and occupation tax treatment of income earned by LendingTree, LLC as consideration for providing an online marketplace allowing consumers to comparison shop for loans. Through its online marketplace, LendingTree connects willing borrowers with willing lenders. The market for this business activity is generated by consumers (prospective borrowers) seeking to “shop, compare, and save on the loans they need” all from “the comfort of their homes.” CP 47.

Service income such as that earned by LendingTree is taxed by Washington using a single-factor apportionment method designed to attribute the income to the state where the customer receives the benefit of the service. RCW 82.04.462. The dispute in this case centers on where LendingTree’s customers (the lenders that contract with LendingTree) receive the benefit of LendingTree’s services.

LendingTree argues that lenders receive the benefit of its online marketplace at the location where those lenders evaluate and respond to a prospective borrower’s loan request. Not so. The argument overlooks the specific services that LendingTree provides. LendingTree provides loan *marketing* services geared towards “targeting” prospective borrowers and connecting those prospective borrowers with willing lenders. CP 46. It provides no services geared towards evaluating or consummating loans. It

follows that lenders receive the benefit of LendingTree's loan marketing services at the location where a "targeted" consumer provides its information to LendingTree to be disseminated to interested lenders. When that targeted consumer is in Washington, the fees LendingTree earns by providing that consumer's information to interested lenders are properly attributed to Washington and included in the Washington apportionment numerator.

LendingTree misapplies the apportionment provisions set out in the business and occupation (B&O) tax code and related administrative rules. When those provisions are properly applied to the undisputed facts, LendingTree is not entitled to the refund it is seeking.

II. RESTATEMENT OF THE ISSUE

Whether the Department correctly concluded that LendingTree's match fee and closed loan fee revenue are included in the numerator of the Washington statutory apportionment formula when the consumer seeking a loan through LendingTree's online marketplace is located in this state.

III. STATEMENT OF THE CASE

A. LendingTree Operates an Online Marketplace for Consumers to Shop for Mortgage Loans and Other Credit Products

LendingTree operates a well known online marketplace that allows consumers seeking mortgage loans or other credit products to shop for and compare conditional loan offerings from multiple lenders.¹ The LendingTree website explains that the company “provides consumers a way to connect with multiple lenders for a number of financial borrowing needs. From the comfort of their homes, consumers can fill out one simple form and are able to shop, compare, and save on the loans they need.” CP 47. The “simple form” mentioned in the website is an online questionnaire through which a consumer seeking a loan provides information about his or her finances and the type of loan being sought. See CP 50-67 (representative online questionnaire). LendingTree refers to the questionnaire as a “QF” or “Qualification Form.” CP 78. After receiving the completed Qualification Form, LendingTree attempts to match that consumer with up to five lenders willing to make a conditional

¹ An online marketplace is a website or app that facilitates shopping from different merchants or providers. The operator of the marketplace does not own inventory or offer direct-to-consumer services. Instead, its business activity is geared towards connecting interested buyers with willing sellers, and facilitating any resulting sale. eBay is a well known example. See generally, Richard Kestenbaum, *What are Online Marketplaces and What is their Future?*, Forbes, April 26, 2017 (online article available at <https://www.forbes.com/sites/richardkestenbaum/2017/04/26/what-are-online-marketplaces-and-what-is-their-future/#1e40fb183284>).

loan offer based on the consumer's credit profile. CP 48. The consumer may then compare the conditional loan offers and elect to work with one of the lenders to complete the loan process. *Id.*

LendingTree does not charge consumers for its service. Instead, the company derives most of its income from fees it charges lenders. Lenders wishing to participate in the marketplace must enter into a service agreement with LendingTree and abide by the LendingTree "Network Participation Terms and Conditions." *See* CP 71 (service agreement) and CP 76 (Terms and Conditions). Under the terms of the agreement, LendingTree charges a "QF Match Fee" for each consumer Qualification Form it transmits to a lender. CP 92. The QF Match Fee is typically \$10 to \$70 per transmittal depending on the type and size of the loan being sought by the consumer. CP 92-95. If the transmitted Qualification Form eventually results in a loan between the lender and the consumer, the lender pays LendingTree a "Closed Loan Fee." CP 92. The Closed Loan Fee is typically \$150 to \$500 per consummated loan depending on the type and size. CP 92-95.²

² LendingTree also earns a small percentage of its income from other miscellaneous activities, including advertising and real estate transactions. However, these other revenue sources are not at issue in this appeal. *See* CR 141 (footnote 4 of LendingTree's summary judgment brief, conceding that the company is not challenging the Department's audit findings with respect to its miscellaneous income).

In exchange for the QF Match Fee and Closed Loan Fee,

LendingTree agrees to perform the following services:

- 4.1 Promotion, Marketing and Maintenance.** LendingTree will promote, market and maintain the LendingTree Site.
- 4.2 Access.** LendingTree will provide Consumers with convenient 24 hour/7 days-a-week secure access via Internet to the LendingTree Site.
- 4.3 Content and Advice.** LendingTree will provide educational content for Consumers related to the purchase and financial process, as well as general advice about the different types of loan and credit products available through the LendingTree Site.
- 4.4 Tools and Resources.** LendingTree will provide access to a variety of tools and resources to help Consumers evaluate the types and amounts of credit for which they may be interested, including for example, loan calculators.
- 4.5 QF Information.** LendingTree will collect QF Information from Consumers through its Qualification Forms.
- 4.6 Evaluation Criteria Comparisons.** LendingTree will compare Consumers' loan preferences, debt, and certain other relevant QF Information to Lender's Evaluation Criteria through the use of LendingTree's proprietary computerized filter systems.
- 4.7 Software and Server Maintenance.** LendingTree will develop and maintain software and servers necessary to facilitate the transmission of QF Information to Lender[.]
- 4.8 Authorization.** LendingTree will obtain advance authorization from Consumers to forward QF Information to Participating Lenders.

4.9 Technical Support. LendingTree will provide related technical support for the data transmission process to Lender.

CP 79. LendingTree has no obligation to perform loan evaluation services or any other services once it has transmitted a consumer's Qualification Form information to a lender. *See id.* at ¶ 5.3 ("Lender shall have sole responsibility for evaluating and responding to Loan Requests and QF Information received through the LendingTree Site or through direct communications between Consumers and Lenders").

B. Department's Audit and Subsequent Procedural History

The Department audited LendingTree for the June 2010 through June 2014 tax periods, resulting in an assessment of B&O tax plus interest and penalties. CP 110. The assessment was amended shortly thereafter to correct an error, resulting in a final assessment in the total amount of \$189,852. CP 126.³

The primary audit adjustment pertained to B&O tax imposed on an apportioned share of LendingTree's Match Fee and Closed Loan Fee revenue. Under the B&O tax apportionment statute, gross income is typically attributed to the state "[w]here the customer received the benefit of the taxpayer's service." RCW 82.04.462(3)(b)(i). Using this criteria, the

³ The initial assessment was corrected to allow a credit for B&O tax that had been paid by LendingTree with its 2010 and 2011 excise tax returns.

Department's auditor concluded that LendingTree's customers received the benefit of LendingTree's online loan marketing services at the location where the consumer seeking the loan is located. CP 115. This resulted in a Washington apportionment percentage of roughly 3% for LendingTree's Match Fee revenue and 2% for the company's Closed Loan Fee revenue. *See, e.g.*, CP 121 (audit workpaper detailing Match Fee apportionment percentages for each year under audit).

The audit findings were upheld by the Department of Revenue's Administrative Review and Hearings Division. CP 242. Shortly thereafter LendingTree paid the assessed amount and timely filed an action for refund under RCW 82.32.180. CP 1.

The parties filed cross-motions for summary judgment. After considering the briefs and arguments of the parties, the superior court granted the Department's motion and denied LendingTree's motion. CP 323. This appeal followed. CP 325.

IV. ARGUMENT

LendingTree claims that the superior court erred when it granted the Department's motion for summary judgment and denied its cross-motion. App. Br. at 2. The claim is unfounded.

A. Standard of Review

LendingTree seeks a refund of B&O tax under RCW 82.32.180. That statute places the burden on LendingTree to prove that the tax it paid was incorrect and to prove the correct amount of tax owed. *Bravern Residential, II, LLC v. Dep't of Revenue*, 183 Wn. App. 769, 776, 334 P.3d 1182 (2014) (citing RCW 82.32.180).

The superior court denied LendingTree's tax refund claim pursuant to cross-motions for summary judgment. This Court reviews a grant of summary judgment de novo, engaging in the same inquiry as the trial court. *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 812, 209 P.3d 524 (2009). Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. CR 56(c).

Here, there were no disputed issues of material fact. Rather, this case involves application of tax statutes to the undisputed facts, which is a question of law. *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011).

B. Washington Adopts a Market-Based Apportionment Method in 2010

The concept of apportionment is rooted in the constitutional principal that a state may not tax value earned outside its borders, but may tax its fair share of an interstate transaction. *See generally Goldberg*

v. *Sweet*, 488 U.S. 252, 261, 109 S. Ct. 582, 102 L. Ed. 2d 607 (1989).

Thus, to prevent impermissible extra-territorial taxation, a state tax on interstate commerce must be fairly apportioned. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977).

“[B]y applying the principles of apportionment, states may tax that part of an interstate transaction which takes place within the state.” *Smith v. State*, 64 Wn.2d 323, 334, 391 P.2d 718 (1964).

States have wide latitude in selecting a method to fairly apportion the income of an interstate business. *Chicago Bridge & Iron Co. v. Dep’t of Revenue*, 98 Wn.2d 814, 824-25, 659 P.2d 463 (1983). In 2010 the Legislature changed the method used to apportion service income to this state, moving from the former “cost” of providing the service approach to a market-oriented “single-factor sales” approach. Laws of 2010, 1st Spec. Sess., ch. 23, § 105 (codified at RCW 82.04.462); *see generally* Laws of 2010, 1st Spec. Sess., ch. 23, § 101(2) (legislative findings supporting the adoption of the new sales factor apportionment method). A market-based apportionment formula like the one Washington adopted in 2010 is designed to reflect the contributions of the market state in generating income. John A. Swain, *Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts*, 83 Tul. L. Rev. 285, 294 (2008). By contrast, the prior “cost” method primarily

reflected the contributions of the “production” state where a taxpayer’s costs of conducting business occur. *Id.* at 288.

The 2010 Washington statute at issue in this appeal apportions service income to this state based on a fraction, the numerator of which is the taxpayer’s “apportionable income” attributable to Washington and the denominator is the taxpayer’s apportionable income everywhere. RCW 82.04.462(2), (3)(a).⁴ Income from service activities is included in the Washington numerator if the taxpayer’s customer received the benefit of the service in this state. RCW 82.04.462(3)(b)(i). In those circumstances where the taxpayer is unable to determine where its customer received the benefit of the services, the statute provides for a cascading series of steps to ascertain by proxy the state where the income must be attributed. RCW 82.04.462(3)(b)(ii)-(vii).

Washington is not unique in adopting a market-based method for apportioning income derived from service activities. Swain, 83 Tul. L. Rev. at 321-23. At least 25 states and the District of Columbia have adopted some form of market-based apportionment. *See generally*, Ilya A. Lipin, Karen LoDico, Robert M. Porcelli, & Michael Vander, *State*

⁴ The term “apportionable income” means service income subject to B&O tax under the “service and other” tax classification as well as other types of gross income specified in RCW 82.04.460(4)(a). *See generally*, WAC 458-20-19401(2)(a) (listing the various B&O tax classifications that are considered “apportionable activities” from which a business receives apportionable income). This appeal pertains only to service income.

Corporate Income Tax Rules for Sourcing of Revenue for Law Firms, ABA Tax Times, vol. 36, no. 4 (Summer 2017), at *4 n.7 (providing citation to enacted market-based apportionment statutes).⁵ Of those 26 state taxing jurisdictions, there are a number that—like Washington—attribute service income to the state where the customer receives the benefit of the taxpayer’s service. *See, e.g.*, Cal. Rev. & T. Code § 25136(a)(1) (West 2019) (“[s]ales from services are in this state to the extent the purchaser of the service receives the benefit of the services in this state”); Mich. Comp. Laws Ann. § 206.665(2)(a) (West 2019) (receipts “are included in the numerator of the apportionment factor if the recipient of the services receives all of the benefit of the services in this state”); Wis. Stat. Ann. § 71.25(9)(dh)(1) (West 2019) (“Gross receipts from services are in this state if the purchaser of the service received the benefit of the service in this state”). Other states have adopted different approaches. *See generally Corporate Executive Bd. Co. v. Virginia Dep’t of Taxation*, 822 S.E.2d 918, 928 (Va. 2019) (states using market-based apportionment have adopted three approaches, “with some taxing services where the benefit is received, others where the service is

⁵ Available online at https://www.americanbar.org/groups/taxation/publications/abataximes_home/17aug/17aug-pp-lipin-et-al-state-corporate-income-tax-rules-for-sourcing-revenue-for-law-firms/ (last viewed March 12, 2019).

delivered, and still others where the receipts are derived”) (citation omitted). But in all cases, the underlying purpose behind market-based apportionment statutes is to recognize the value created by the state in which a service provider is able to market and sell its services.

C. The Department Correctly Applied the Market-Based Apportionment Method

LendingTree’s opening brief is primarily devoted to Department interpretive Rule 19402 (WAC 458-20-19402), arguing that the “plain meaning” of the Rule supports its claim for a tax refund. App. Br. at 9. However, LendingTree’s “plain meaning” analysis fails to read the Rule as a whole and in context. When read in context and in light of the examples provided, the Rule is entirely consistent with the language and purpose of the statute and supports the superior court’s grant of summary judgment to the Department.

1. Department Rule 19402 and related public guidance provide a framework for attributing income to the state where the customer received the benefit.

The Department promulgated WAC 458-20-19402 (Rule 19402) to aid in its enforcement of the single-factor sales apportionment statute.⁶ As relevant here, subsection 303 of that Rule provides a framework for determining where the benefit of a service is received. In those cases

⁶ A copy of Rule 19402 is provided as Appendix A.

where a taxpayer's service does not relate to real or personal property and is provided to a customer engaged in business, "the benefit is received where the customer's related business activity occurs." WAC 458-20-19402(303)(c). The term "related business activity" refers to the customer's business activity "that most closely or directly relates to the services performed by the taxpayer." Department of Revenue, *Interim Statement Regarding the Attribution of Receipts from R&D Services*, p. 2 (June 22, 2017), CP 272.

Determining where a customer's related business activity occurs is typically analyzed by asking the following three questions:

- What service is the taxpayer performing?
- What is the customer's most closely or directly related business activity?
- Where does the customer's related business activity occur?

LendingTree fails to properly address the first two steps—which leads it to misidentify "where" its customers' related business activity occurs. *See* App. Br. at 10.

When properly applied, Department Rule 19402(303)(c) supports the conclusion that lenders receive the benefit of LendingTree's online marketplace at the location where the consumer seeking the loan is located. LendingTree is in the business of connecting willing borrowers

with willing lenders. The market for its business activity is generated by consumers (prospective borrowers) seeking to “shop, compare, and save on the loans they need” all from “the comfort of their homes.” CP 47. It follows that lenders paying for LendingTree’s services receive the benefit at the market-state where the consumer is located, as the Department correctly concluded.

2. LendingTree performs loan marketing services that bring together borrowers and lenders.

To properly evaluate an interstate service provider’s business activity under Washington’s market-based apportionment method, it is important to correctly identify the specific services the taxpayer is performing. Here, it is undisputed that LendingTree performs a variety of consumer-oriented marketing services geared towards attracting potential borrowers to its website in order to expand its customers’ footprint in the consumer loan market. Those services include promoting, marketing, and maintaining its website, offering borrowers convenient “24 hour/7 days-a-week secure access” to its website, providing “educational content” and advice related to consumer loans available through its website, and providing access to other consumer-oriented “tools and resources.” *See* CP 79 (list of specific services provided by LendingTree).

The services offered through the LendingTree marketplace are designed to empower borrowers by providing a convenient way to connect with willing lenders. CP 46-47. By bringing together interested borrowers and willing lenders, LendingTree provides a “win-win solution” that assists consumers in making informed financial decisions and assists lenders in expanding the reach of their marketing activities. CP 46, CP 102.

3. LendingTree’s loan marketing services directly relate to its customers’ loan marketing activities.

The various services LendingTree provides through its online marketplace are directly related to its customers’ loan marketing activities. Lenders use LendingTree “to target consumers whose needs they [are] best prepared to meet.” CP 46. In short, by partnering with LendingTree, a lender is able to “instantly expand” its reach by connecting with LendingTree’s “network of 30 billion borrowers.” CP 102. For a lender, signing on with LendingTree is “like adding an entire marketing department to your company – overnight.” *Id.*

Notwithstanding the admissions in its online marketing materials, LendingTree argues in this tax refund case that its customers’ “related business activity” consists of processing, evaluating, and responding to borrower loan information. App. Br. at 1, 10. The argument is incorrect

because it fails to properly identify the specific services LendingTree provides. As is clearly spelled out in its service contract, LendingTree provides no services directly relating to a lender's evaluation or consummation of a loan. Rather, lenders "have sole responsibility for evaluation and responding to Loan Request and QF Information received through the LendingTree Site or through direct communications between Consumers and Lender." CP 79 (quoting paragraph 5.3 of agreement).

Instead of focusing on the customer's business activity that most closely relates to the services LendingTree is providing, LendingTree focuses on customer business activities that have no direct relationship with LendingTree's online marketing and promotion. While a lender might evaluate QF information from its business location, that evaluation process is not the business activity most closely aligned to LendingTree's marketing services. This disconnect between the loan marketing services LendingTree is providing and the loan evaluation activities conducted solely by its customers is fatal to LendingTree's refund claim.

4. LendingTree's customers' related business activity occurs in Washington when targeting a Washington consumer.

The final step in attributing gross receipts under Rule 19402 requires identification of "where" the customer's related business activity occurs. Because LendingTree has misapplied the first two analytical

steps, it reaches an incorrect conclusion with respect to the third.

Specifically, LendingTree argues that all lenders that utilize its online marketplace receive the benefit of its service “at [the customers’] specified business locations” because that is the location where lenders evaluate and respond to loan requests. App. Br. at 11. LendingTree goes on to argue that lenders engage in no business activity in Washington. App. Br. at 12. Both claims are incorrect.

a. Lenders receive the benefit at the location where potential borrowers are located.

In those cases where the taxpayer’s service is most closely related to its customer’s selling or marketing business activity, the location of that related business activity is the customer’s market—i.e., the location where its sales activity is directed. Two examples in Rule 19402 help make this point.

In Rule 19402(304)(c) (Example 21), the Department provides the following example pertaining to the attribution of receipts from services that directly relate to a customer’s selling activity:

Call Center provides “customer service” services to Retailer who has customers in all 50 states. *Call Center’s services relate to Retailer’s selling activity* in all 50 states, therefore Retailer receives the benefit of Call Center’s services in all 50 states. . . . Call Center may attribute receipts received from Retailer based on the number of calls from area codes assigned to each state. . . .

WAC 458-20-19402(304)(c) (Example 21) (emphasis added).

Similarly, Example 17 provides:

Debt Collector provides debt collection services to ABC. *The benefit of Debt Collector's services relate to ABC's selling activity in various states.* It is reasonable to assume that where the debtors are located is the same as where ABC's business activity occurred. If Debt Collector is able to attribute specific receipts to a specific debtor, then the receipt is *attributed to where the debtor is located.*

WAC 458-20-19402(304)(c) (Example 17) (emphasis added). These examples show that when income is received from services directly relating to a customer's selling or marketing business activities, it is necessary to attribute that income to the location of the customer's market, not the customer's physical location.

Conversely, when the taxpayer's service most closely relates to a customer's internal business function such as training employees, income received for that service is attributed to the location where the internal business function occurs. *See, e.g.,* WAC 458-20-19402(304)(c) (Example 19). This dichotomy between services directly relating to a customer's selling and marketing activity and services directly relating to "non-marketing" activity is consistent with the language and purpose of Washington's apportionment statute—which is designed to reflect the contributions of the market state in generating income. It is also consistent with the manner in which other states with similar statutes attribute service income. *See* Cal Franchise Tax Bd. Chief Counsel

Ruling 2015-03 (Dec. 31, 2015) (under California’s market-based apportionment statute, “non-marketing” services are attributed to the location where the taxpayer’s customer uses the service in its business while “marketing” services are attributed to the location of the “taxpayer’s customer’s customers”).⁷

As noted above, LendingTree is in the business of enticing borrowers to sign up on its website in order to connect those borrowers with willing lenders. It follows that LendingTree’s customers (lenders) received the benefit of LendingTree’s online marketplace services at the location where the prospective borrower is located. And when the prospective borrower is located in Washington, the fees earned by LendingTree are correctly included in the numerator of the Washington apportionment formula.

b. Lenders engage in business activity in this state when they seek out and compete for Washington consumers

LendingTree also incorrectly claims that its customers conduct no business activity in Washington. App. Br. at 12. In making the claim, LendingTree conveniently ignores the fact that its customers are actively competing for a share of the Washington consumer loan market and are using LendingTree’s online marketplace to facilitate that activity. The

⁷ The California FTB Chief Counsel Ruling is provided as Appendix B.

company also ignores the fact that it has created a very successful business model that is designed to allow banks to compete for business remotely. In sum, LendingTree ignores the business activity of its customers that is most directly connected with LendingTree's online marketplace.

It is common knowledge that business activity is often conducted remotely. As recently recognized by the United States Supreme Court, in today's interconnected digital economy "a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." *South Dakota v. Wayfair, Inc.*, ___ U.S. ___, 138 S. Ct. 2080, 2095, 201 L. Ed. 2d 403 (2018) (internal quotations omitted) (quoting *Direct Marketing Assn. v. Brohl*, 575 U.S. ___, 135 S. Ct. 1124, 1135, 191 L. Ed. 2d 97 (2015) (Kennedy, J., concurring)). It is "an inescapable fact of modern commercial life that a substantial amount of business is transacted . . . [with no] need for physical presence within a State in which business is conducted." *Id.* at 138 S. Ct. 2093 (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 308, 112 S. Ct. 1094, 119 L. Ed. 2d 91 (1992)). The Washington B&O tax statutes reflect this reality. *See* RCW 82.04.066 (the term "engaging within this state" means that the person "generates gross income of the business from sources within the

state, such as customers or intangible property located in this state, regardless of whether the person is physically present in this state”).

LendingTree’s contention that its customers do not conduct business in Washington merely because they might not physically travel into the state to market and sell their credit products is out of step with the law and out of step with reality. Banks and other lenders regularly engage in business in various states without any physical location or in-state employees. *See, e.g., Tax Comm’r v. MBNA Am. Bank, N.A.*, 220 W. Va. 163, 640 S.E.2d 226, 234 (W. Va. 2006) (upholding a state tax imposed on a bank that had a substantial economic presence with the state as a result of purposefully exploiting the “local market”). Moreover, as noted above, LendingTree has built a successful business that utilizes its virtual marketplace to bring together consumers seeking loans with banks wishing to offer loans. Banks seek out and compete for the business of Washington consumers through the very services that LendingTree provides, and without the need to send employees into the state to physically conduct those solicitation activities.

LendingTree cannot avoid the fair application of the state’s apportionment statute by arguing its customers utilize LendingTree’s services only in the state where the customer is physically located. Lenders that sign up to use the LendingTree online marketplace are

engaging in business activity in Washington when they use that marketplace as a vehicle to seek out and offer loans to Washington consumers. Those lenders receive the benefit of LendingTree's services in Washington when the prospective borrower is located in Washington. Under Washington's apportionment statute—RCW 82.04.462—it follows that income derived by LendingTree from matching willing lenders with Washington consumers is correctly included in the numerator of the Washington apportionment factor.

V. CONCLUSION

For the reasons set forth, the Department respectfully requests that the Court affirm the superior court's order granting summary judgment to the Department. The superior court properly applied the law—including Department interpretive Rule 19402—when it granted the Department's motion for summary judgment and dismissed LendingTree's B&O tax refund claim.

RESPECTFULLY SUBMITTED this 27th day of March, 2019.

ROBERT W. FERGUSON
Attorney General


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Assistant Attorney General
Attorneys for Respondent

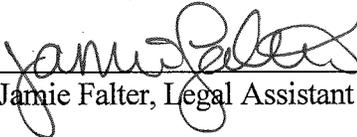
PROOF OF SERVICE

I certify that on March 27, 2019, I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal, which will send notification of such filing to all counsel of record at the following:

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cc: Docketing-SEA@lanepowell.com

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

DATED this 27th day of March, 2019, at Tumwater, WA.



Jamie Falter, Legal Assistant

APPENDIX A

WAC 458-20-19402**Single factor receipts apportionment—Generally.****PART 1. INTRODUCTION.**

(101) **General.** RCW 82.04.462 establishes the apportionment method for businesses engaged in apportionable activities and that have nexus with Washington for business and occupation (B&O) tax liability incurred after May 31, 2010. The express purpose of the change in the law was to require businesses "earn(ing) significant income from Washington residents from providing services" to "pay their fair share of the cost of services that this state renders and the infrastructure it provides." Section 101, chapter 23, 1st special session, 2010.

(102) **Guide to this rule.** This rule is divided into six parts, as follows:

1. Introduction.
2. Overview of single factor receipts apportionment.
3. How to attribute receipts.
4. Receipts factor.
5. How to determine Washington taxable income.
6. Reporting instructions.

(103) **Scope of rule.** This rule applies to the apportionment of income from engaging in apportionable activities as defined in WAC 458-20-19401, except:

- (a) To the apportionment of income received by financial institutions and taxable under RCW 82.04.290, which is governed by WAC 458-20-19404; and
- (b) To the attribution of royalty income from granting the right to use intangible property, which is governed by WAC 458-20-19403.

(104) **Separate accounting and cost apportionment.** The apportionment method explained in this rule replaces the previously allowed separate accounting and cost apportionment methods. Separate accounting and cost apportionment are not authorized for periods after May 31, 2010.

(105) **Other rules.** Taxpayers may also find helpful information in the following rules:

(a) **WAC 458-20-19401 Minimum nexus thresholds for apportionable activities.** This rule describes minimum nexus thresholds applicable to apportionable activities that are effective after May 31, 2010.

(b) **WAC 458-20-19403 Royalty receipts attribution.** This rule describes the attribution of royalty income for the purposes of single factor receipts apportionment and applies only to tax liability incurred after May 31, 2010.

(c) **WAC 458-20-19404 Single factor receipts apportionment—Financial institutions.** This rule describes the application of single factor receipts apportionment to certain income of financial institutions and applies only to tax liability incurred after May 31, 2010.

(d) **WAC 458-20-194 Doing business inside and outside the state.** This rule describes separate accounting and cost apportionment and applies only to tax liability incurred from January 1, 2006, through May 31, 2010.

(e) **WAC 458-20-14601 Financial institutions—Income apportionment.** This rule describes the apportionment of income for financial institutions for tax liability incurred prior to June 1, 2010.

(106) **Definitions.** The following definitions apply to this rule:

(a) **"Apportionable activities"** has the same meaning as used in WAC 458-20-19401 Minimum nexus thresholds for apportionable activities.

(b) **"Apportionable income"** means apportionable receipts less the deductions allowable under chapter 82.04 RCW.

(c) "**Apportionable receipts**" means gross income of the business from engaging in apportionable activities, including income received from apportionable activities attributed to locations outside this state.

(d) "**Business activities tax**" means a tax measured by the amount of, or economic results of, business activity conducted in a state. The term includes taxes measured in whole or in part on net income or gross income or receipts. In the case of sole proprietorships and pass-through entities, the term includes personal income taxes if the gross income from apportionable activities is included in the gross income subject to the personal income tax. The term "business activities tax" does not include retail sales, use, or similar transaction taxes, imposed on the sale or acquisition of goods or services, whether or not named a gross receipts tax or a tax imposed on the privilege of doing business.

(e) "**Customer**" means a person or entity to whom the taxpayer makes a sale, grants the right to use intangible property, or renders services or from whom the taxpayer otherwise directly or indirectly receives gross income of the business. If the taxpayer performs apportionable services for the benefit of a third party, the term "customer" means the third party beneficiary.

Example 1. Assume a parent purchases apportionable services for their child. The child is the customer for the purpose of determining where the benefit is received.

(f) "**Reasonable method of proportionally attributing**" means a method of determining where the benefit of an activity is received and where the receipts are attributed that is uniform, consistent, and accurately reflects the market, and does not distort the taxpayer's market.

(g) "**State**" means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

(h)(i) "**Taxable in another state**" means either:

(A) The taxpayer is subject to a business activities tax by another state on the taxpayer's income received from engaging in apportionable activity; or

(B) The taxpayer is not subject to a business activities tax by another state on the taxpayer's income received from engaging in apportionable activity, but the taxpayer meets the substantial nexus thresholds described in WAC 458-20-19401 for that state.

(ii) The determination of whether a taxpayer is taxable in a foreign country or political subdivision of a foreign country is made at the country or political subdivision level.

Example 2. Assume Taxpayer A is subject to a business activity tax in State X of Mexico (e.g., Taxpayer pays tax to State X), but nowhere else in Mexico. Also, assume that Taxpayer A is not subject to any national business activity tax in Mexico and does not meet the substantial nexus thresholds described in WAC 458-20-19401 for Mexico as a whole. In this case, Taxpayer is taxable in State X, but not taxable in any other portion or any other State of Mexico.

Example 3. Assume Taxpayer B is not subject to any business activity taxes in Mexico, but satisfies the substantial nexus thresholds described in WAC 458-20-19401 for Mexico as a whole. Taxpayer B is taxable in all of Mexico.

PART 2. OVERVIEW OF SINGLE FACTOR RECEIPTS APPORTIONMENT.

(201) **Single factor receipts apportionment generally.** Except as provided in WAC 458-20-19404 persons earning apportionable income who have substantial nexus with Washington as specified in WAC 458-20-19401 and who are also taxable in another state must use the apportionment method provided in this rule to determine their taxable income from apportionable activities for B&O tax purposes. Taxable income is determined by multiplying apportionable income from each apportionable activity by the receipts factor for that apportionable activity.

This formula is:

$$\begin{array}{c} \text{(Taxable} \\ \text{income)} \end{array} = \begin{array}{c} \text{(Apportionable} \\ \text{income)} \end{array} \times \begin{array}{c} \text{(Receipts} \\ \text{factor)} \end{array}$$

See Part 4 of this rule for a discussion of the receipts factor.

(202) **Tax year.** The receipts factor applies to each tax year. A tax year is the calendar year, unless the taxpayer has specific permission from the department to use another period. (RCW 82.32.270.) For the purposes of this rule, "tax year" and "calendar year" have the same meaning.

PART 3. HOW TO ATTRIBUTE RECEIPTS.

(301) **Attribution of receipts generally.** Except as specifically provided for in WAC 458-20-19403 for the attribution of apportionable royalty receipts, this Part 3 explains how to attribute apportionable receipts. Receipts are attributed to states based on a cascading method or series of steps. The department expects that most taxpayers will attribute apportionable receipts based on (a) (i) of this subsection because the department believes that either the taxpayer will know where the benefit is actually received or a "reasonable method of proportionally attributing receipts" will generally be available. These steps are:

(a) Where the customer received the benefit of the taxpayer's service (see subsection (302) of this rule for an explanation and examples of the benefit of the service);

(i) If a taxpayer can reasonably determine the amount of a specific apportionable receipt that relates to a specific benefit of the services received in a state, that apportionable receipt is attributable to the state in which the benefit is received. When a customer receives the benefit of the taxpayer's services in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state. This may be shown by application of a reasonable method of proportionally attributing the benefit among states. The result determines the receipts attributed to each state. Under certain situations, the use of data based on an attribution method specified in (b) through (f) of this subsection may also be a reasonable method of proportionally attributing receipts among states (see Examples 4 and 5 below).

(ii) If a taxpayer is unable to separately determine or use a reasonable method of proportionally attributing the benefit of the services in specific states under (a)(i) of this subsection, and the customer received the benefit of the service in multiple states, the apportionable receipt is attributed to the state in which the benefit of the service was primarily received. Primarily means, in this case, more than fifty percent.

(b) If the taxpayer is unable to attribute an apportionable receipt under (a) of this subsection, the apportionable receipt must be attributed to the state from which the customer ordered the service.

(c) If the taxpayer is unable to attribute an apportionable receipt under (a) or (b) of this subsection, the apportionable receipt must be attributed to the state to which the billing statements or invoices are sent to the customer by the taxpayer.

(d) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), or (c) of this subsection, the apportionable receipt must be attributed to the state from which the customer sends payment to the taxpayer.

(e) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), (c), or (d) of this subsection, the apportionable receipt must be attributed to the state where the customer is located as indicated by the customer's address:

(i) Shown in the taxpayer's business records maintained in the regular course of business; or

(ii) Obtained during consummation of the sale or the negotiation of the contract, including any address of a customer's payment instrument when readily available to the taxpayer and no other address is available.

(f) If the taxpayer is unable to attribute an apportionable receipt under (a), (b), (c), (d), or (e) of this subsection, the apportionable receipt must be attributed to the commercial domicile of the taxpayer.

(g) The taxpayer may not use an attribution method that distorts the apportionment of the taxpayer's apportionable receipts.

(302) **Examples.** Examples included in this rule identify a number of facts and then state a conclusion; they should be used only as a general guide. The tax results of all situations must be determined after a review of all the facts and circumstances. The examples in this rule assume all gross income received by the taxpayer is from engaging in apportionable activities. Unless otherwise stated, the examples do not apply to tax liability prior to June 1, 2010.

When an example states that a particular attribution method is a reasonable method of proportionally attributing the benefit of a service, this does not preclude the existence of other reasonable methods of proportionally attributing the benefit depending on the specific facts and circumstances of a taxpayer's situation.

Example 4. Assume Law Firm has thousands of charges to clients. It is not commercially reasonable for Law Firm to track each charge to each client to determine where the benefit related to each service is received. Assume the scope of Law Firm's practice is such that it is reasonable to assume that the benefits of Law Firm's services are received at the location of the customer as reflected by the customer's billing address. Under these circumstances, Law Firm can use the billing addresses of each client as a reasonable method of proportionally attributing the benefit of its services.

Example 5. Same facts as Example 4 except, Law Firm has a single client that represents a statistically significant portion of its revenue and whose billing address is unrelated to any of the services provided. In this case, using the billing address of this client would not relate to the benefit of the services. Using the billing address for this client to determine where the benefit is received would significantly distort the apportionment of Law Firm's receipts. Therefore, Law Firm would need to evaluate the specific services provided to that client to determine where the benefits of those services are received and may use billing address to attribute the income received from other clients.

Example 6. Assume Taxpayer R attributes an apportionable receipt based on its customer's billing address, using (c) of this subsection, and the billing address is a P.O. Box located in another state. Taxpayer R also knows that mail delivered to this P.O. Box is automatically forwarded to the customer's actual location. In this case, use of the billing address is not allowed because it would distort the apportionment of Taxpayer R's receipts.

(303) **Benefit of the service explained.** The first two steps (subsection (301)(a)(i) and (ii) of this rule) used to attribute apportionable receipts to a state are based on where the taxpayer's customer receives the benefit of the service. This subsection explains the framework for determining where the benefit of a service is received.

(a) **If the taxpayer's service relates to real property, then the benefit is received where the real property is located.** The following is a nonexclusive list of services that relate to real property:

- (i) Architectural;
- (ii) Surveying;
- (iii) Janitorial;
- (iv) Security;
- (v) Appraisals; and
- (vi) Real estate brokerage.

(b) **If the taxpayer's service relates to tangible personal property, then the benefit is received where the tangible personal property is located or intended/expected to be located.**

(i) Tangible personal property is generally treated as located where the place of principal use occurs. If the tangible personal property is subject to state licensing (e.g., motor vehicles), the principal place of use is presumed to be where the property is licensed; or

(ii) If the tangible personal property will be created or delivered in the future, the principal place of use is where it is expected to be used or delivered.

(iii) The following is a nonexclusive list of services that relate to tangible personal property:

- (A) Designing specific/unique tangible personal property;
- (B) Appraisals;
- (C) Inspections of the tangible personal property;
- (D) Testing of the tangible personal property;
- (E) Veterinary services; and
- (F) Commission sales of tangible personal property.

(c) If the taxpayer's service does not relate to real or tangible personal property, the service is provided to a customer engaged in business, and the service relates to the customer's business activities, then the benefit is received where the customer's related business activities occur. The following is a nonexclusive list of business related services:

- (i) Developing a business management plan;
- (ii) Commission sales (other than sales of real or tangible personal property);
- (iii) Debt collection services;
- (iv) Legal and accounting services not specific to real or tangible personal property;
- (v) Advertising services; and
- (vi) Theater presentations.

(d) If the taxpayer's service does not relate to real or tangible personal property, is either provided to a customer not engaged in business or unrelated to the customer's business activities; and:

(i) The service requires the customer to be physically present, then the benefit is received where the customer is located when the service is performed. The following is a nonexclusive list of services that require the customer to be physically present:

- (A) Medical examinations;
- (B) Hospital stays;
- (C) Haircuts; and
- (D) Massage services.

(ii) The taxpayer's service relates to a specific, known location(s), then the benefit is received at those location(s). The following is a nonexclusive list of services related to specific, known location(s):

- (A) Wedding planning;
- (B) Receptions;
- (C) Party planning;
- (D) Travel agent and tour operator services; and
- (E) Preparing and/or filing state and local tax returns.

(iii) If (d)(i) and (ii) of this subsection do not apply, the benefit of the service is received where the customer resides. The following is a nonexclusive list of services whose benefit is received at the customer's residence:

- (A) Drafting a will;
- (B) Preparing and/or filing federal tax returns;
- (C) Selling investments; and
- (D) Blood tests (not blood drawing).

(e) Special rule for extension of credit. See subsection (305) of this rule for special rules attributing income related to loans (secured and unsecured) and credit cards that is received by persons who are not financial institutions as defined in WAC 458-20-19404.

(304) Examples of the application of the benefit of service analysis and reasonable methods of proportionally attributing receipts.

(a) Services related to real property:

Example 7. Architect drafts plans for a building to be built in Washington. Architect's services relate to real property which is located in Washington, therefore the customer receives the benefit of that service in Washington at the location of the real property. Architect's receipts for this service are solely attributed to Washington because the entire benefit is received in Washington.

Example 8. Franchisor hires Taxpayer, an architect, to create a design of a standardized building that will be used at four locations in Washington and two locations in Oregon. Taxpayer's services relate to real property at those six locations, therefore the customer receives the benefit of the service at the four Washington locations and the two Oregon locations. Taxpayer will attribute 2/3 (4 of 6 sites) of the receipts for this service to Washington and 1/3 (2 of 6 sites) of the receipts to Oregon.

Example 9. Assume the same facts as Example 8 except Franchisor will use the same design in all 50 states for all its franchisee's locations. Taxpayer and Franchisor do not know at the time the service is provided (and cannot reasonably estimate) how many franchise locations will exist in each state. Therefore, there is no reasonable means of proportionally attributing receipts at the time the services are performed and it is clear that no state will have a majority of the franchise locations. Accordingly, the apportionable receipts must be attributed following the steps in subsection (301)(b) through (f) of this rule.

Example 10. Real estate broker located in Florida receives a commission for arranging the sale of real property located in Washington. The real estate broker's service is related to the real property, therefore the benefit is received in Washington, where the real property is located, and the commission income is attributed to Washington.

(b) Services related to tangible personal property.

Example 11. Big Manufacturing hires an engineer to design a tool that will only be used in a factory located in Brewster, Washington. Big Manufacturing receives the benefit of the engineer's services at a single location in Washington where the tool is intended to be used. Therefore, 100% of engineer's receipts from this service must be attributed to Washington.

Example 12. The same facts as in Example 11, except Big Manufacturing will use the tool equally in factories located in Brewster and in Kapa'a, Hawai'i. Therefore, Big Manufacturer receives the benefit of the service equally in two states. Because the benefit of the service is received equally in both states, a reasonable method of proportionally attributing receipts would be to attribute 1/2 of the receipts to each state.

Example 13. Taxpayer, a commissioned salesperson, sells tangible personal property (100 widgets) for Distributor to XYZ Company for delivery to Spokane. Distributor receives the benefit of Taxpayer's service where the tangible personal property will be delivered. Therefore, Taxpayer will attribute the commission from this sale to Washington.

Example 14. Same facts as in Example 13, but the widgets are to be delivered 50 to Spokane, 25 to Idaho, and 25 to Oregon. In this case, the benefit is received in all three states. Taxpayer shall attribute the receipts (commission) from this sale 50% to Washington, 25% to Idaho, and 25% to Oregon where the tangible personal property is delivered to the buyer.

Example 15. Training Company provides training to Customer's employees on how to operate a specific piece of equipment used solely in Washington. Customer receives the benefit of the service where the equipment is used, which is in Washington. Therefore, Training Company will attribute 100% of its receipts received from Customer to Washington.

(c) Services related to customer's business activities. The examples in this subsection assume that the customer is engaged in business and the services relate to the customer's business activities.

Example 16. Manufacturer hires Law Firm to defend Manufacturer in a class action product liability lawsuit involving Manufacturer's Widgets. The benefit of Law Firm's services relates to

Manufacturer's widget selling activity in various states. A reasonable method of proportionally attributing receipts in this case would be to attribute the receipts to the locations where the Manufacturer's Widgets were delivered, which relates to Manufacturer's business activities.

Example 17. Debt Collector provides debt collection services to ABC. The benefit of Debt Collector's services relates to ABC's selling activity in various states. It is reasonable to assume that where the debtors are located is the same as where ABC's business activity occurred. If Debt Collector is able to attribute specific receipts to a specific debtor, then the receipt is attributed to where the debtor is located.

Example 18. Same facts as Example 17, except Debt Collector is unable to attribute specific benefits with specific debtors. In this case, a reasonable method of proportionally attributing benefits/receipts should be employed. Depending on Debt Collector's specific facts and circumstances, a reasonable method of proportionally attributing benefits/receipts could be: Relative number of debtors in each state; relative debt actually collected from debtors in each state; the relative amount of debt owed by debtors in each state; or another method that does not distort the apportionment of Debt Collector's receipts.

Example 19. Training Company provides training to Customer's employees who are all located in State A. The training is provided in State B. The training relates to the employees' ethical behavior within Customer's organization. Customer receives the benefit of Training Company's service in State A, where Customer's office is located and the employees presumably practice their ethical behavior. Training Company must attribute the apportionable receipts to State A where the benefit is solely received.

Example 20. Same facts as Example 19, except the training is provided for employees from several states and Training Company knows where each employee works. The benefit of the Training Company's services is received in those several states. Attributing receipts from the training based on where the employees work is a reasonable method of proportionally attributing the receipts income.

Example 21. Call Center provides "customer service" services to Retailer who has customers in all 50 states. Call Center's services relate to Retailer's selling activity in all 50 states, therefore Retailer receives the benefit of Call Center's services in all 50 states. Call Center has offices in Iowa and Alabama that answer questions about Retailer's products. Call Center records Retailer's customer's calls by area code. Call Center may attribute receipts received from Retailer based on the number of calls from area codes assigned to each state. This would be a reasonable method of proportionally attributing receipts notwithstanding the fact that mobile phone numbers and related area codes may not exactly reflect the physical location of the customer in all cases.

Example 22. Taxpayer provides internet advertising services to national retail chains, regional businesses, businesses with a single location, and businesses that operate solely over the Internet. Generally, the benefit of the advertising services is received where the customer's related business activities occur. Depending on what products or services are being provided by Taxpayer's customers, the use of relative population in the customer's market may be a reasonable method of proportionally attributing the benefit of Taxpayer's services.

Example 23. Oregon Newspaper sells newspaper advertising to Merlin's Potion Shop. Merlin's only makes over-the-counter sales from its single location in Vancouver, Washington. Merlin's Potion Shop receives the benefit of the Oregon Newspaper's advertising services in Washington where it makes sales to its customers. In this case Oregon Newspaper will report 100% of its receipts received from Merlin's to Washington.

Example 24. Company A provides human resources services to Racko, Inc. which has three offices that use those services in Washington, Oregon, and Idaho. Racko sells widgets and has customers for its widgets in all 50 states. The benefit of the service performed by Company A is received at Racko's locations in Washington, Oregon, and Idaho. Assuming that each office is approximately the same size and uses the services to approximately the same extent, then attributing

1/3 of the receipts to each of the states in which Racko has locations using the services is a reasonable method of proportionally attributing Company A's receipts from Racko.

Example 25. Director serves on the board of directors for DEF, Inc. Director's services relate to the general management of DEF, Inc. DEF, Inc. is Director's customer and receives the benefit of Director's services at its corporate domicile. Therefore, Director must attribute the receipts earned from Director's services to DEF to DEF's corporate domicile.

(d) Services not related to real or tangible personal property and either provided to customers not engaged in business or unrelated to the customer's business activities.

Example 26. A Washington resident travels to California for a medical procedure. Because the Washington resident must be physically in California, the Washington resident receives the benefit of the service in California. Therefore, the service provider must attribute its income from the procedure to California.

Example 27. Washington accountant prepares a Nevada couple's Arizona and Oregon state income tax returns as well as their federal income tax return. The benefit of the accountant's service associated with the state income tax returns is attributed to Arizona and Oregon because these returns relate to specific locations (states). The benefit associated with the federal income tax return is attributed to the couple's residence. The fees for the state tax returns are attributed to Arizona and Oregon, respectively, and the fee for the federal income tax return is attributed to Nevada.

Example 28. Tour Operator provides cruises through Washington's San Juan Islands for four days and Victoria, British Columbia for one day. The benefit of the tour is received where the tour occurs. Tour Operator may use a reasonable method of proportionally attributing the benefit to determine that its customers receive 80% of the benefit in Washington and 20% outside of Washington. Therefore, Tour Operator must attribute 80% of apportionable receipts to Washington and 20% to British Columbia.

Example 29. A Washington couple hires a Washington attorney to prepare a last will and testament for Daughter who lives in California. Daughter is a third-party beneficiary and receives the benefit of the attorney's services in California because that is where Daughter lives. Washington Attorney must attribute the fee to California.

Example 30. A Washington couple hires a California accountant to prepare their joint federal income tax return. Because the couple does not have to be physically present for the accountant to perform services and services are not related to a specific location, the Washington couple receives the benefit of the accountant's services at their residence in Washington. California accountant must attribute its fee for this service to Washington.

Example 31. An Arizona resident retains a Washington stock broker to handle its investments. The stock broker receives orders from the client and executes trades of securities on the New York Stock Exchange. Because (a) the Arizona resident is not investing as part of a business; (b) the activity does not relate to real or tangible personal property; (c) and the client does not need to be physically present for the stock broker to perform its services; and (d) the services are not related to a specific location, the client receives the benefit of the services at client's place of residence. Washington stockbroker must attribute the fee to Arizona.

Example 32. Investment Manager manages a mutual fund. Investment Manager receives a fee for managing the fund based on the value of the assets in the fund on particular days. Investment Manager knows or should know the identity of the investors in the fund and their mailing addresses. The fees received by Investment Manager (whether from the mutual fund or from individual investor's accounts) are for the services provided to the investors. Investment Manager's services do not relate to real or tangible personal property and do not require that the client be physically present, therefore, the benefit of Investment Manager's services is received where the investors are located and Investment Manager's apportionable receipts must be attributed to those locations.

(305) Special rules related to extending credit performed by nonfinancial institutions.

Businesses not included in the definition of a financial institution under WAC 458-20-19404 that provide services related to the extension of credit must attribute their income from such activities as follows:

(a) Activities related to extending credit where real property secures the debt. Such activities include, but are not limited to, servicing loans, making loans subject to deeds of trust or mortgages (including any fees in the nature of interest related to the loan), and buying and selling loans. Apportionable receipts from these activities are attributed in the same manner as a financial institution attributes these apportionable receipts under WAC 458-20-19404.

(b) Activities related to credit cards. Such activities include, but are not limited to, issuing credit cards, servicing, and billing. Apportionable receipts from these activities are attributed to the billing address of the card holder.

(c) Other activities related to extending credit where real property does not secure the debt. Such activities include, but are not limited to, servicing loans, making loans (including any fees related to such loans), and buying and selling loans. Apportionable receipts from these activities are attributed in the same manner a financial institution attributes income under WAC 458-20-19404.

(d) All other apportionable receipts from such businesses are attributed using subsections (301) through (304) of this rule or WAC 458-20-19403.

(306) What does "unable to attribute" mean? A taxpayer is "unable to attribute" apportionable receipts when the taxpayer has no commercially reasonable means to acquire the information necessary to attribute the apportionable receipts. Cost and time may be considered to determine whether a taxpayer has no commercially reasonable means to acquire the information necessary to attribute apportionable receipts.

Example 33. One office of ZYX LLC has information that can easily be used to determine a reasonable proportional attribution of receipts, but does not provide this information to the office preparing the tax returns. ZYX LLC must use the information maintained by the marketing office to attribute its receipts.

Example 34. CBA, Inc. is entitled to receive information from an affiliate or unrelated third party which it could use to determine where the benefit of its services is received but chooses not to obtain that information. CBA, Inc. must use the information maintained by the affiliate or unrelated third party to attribute its apportionable receipts.

Example 35. Same facts as Example 34, except that the information is raw data that must be formatted and otherwise processed at a cost that exceeds a reasonable estimate of the possible difference in the amount of tax CBA, Inc. would owe if used another attribution method authorized in subsection (301) (b) through (f) of this rule. In this case, it is not commercially reasonable for CBA, Inc. to use this data to determine where to attribute its income.

PART 4. RECEIPTS FACTOR.

(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:

$$\text{(Receipts factor)} = \frac{\text{(Washington apportionable receipts)}}{\text{((Worldwide apportionable receipts) - (Throw-out income))}}$$

(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.

Example 36. NOP, Inc. has \$400,000 of receipts attributed to Washington and \$1,000,000 of worldwide receipts. Assuming that there is no throw-out income, NOP's receipts factor is 40% ($400,000/1,000,000$).

(c) In the very rare situation where the receipts factor (after reducing the denominator by the throw-out income) is zero divided by zero, the receipts factor is deemed to be zero.

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

(a) Is not taxable (see subsection (106) of this rule); and

(b) At least part of the activity of the taxpayer related to the throw-out income is performed in Washington.

Example 37. XYZ Corp. performs all services in Washington and has apportionable receipts attributed using the criteria listed in subsections (301) through (305) of this rule or WAC 458-20-19403 as follows: Washington \$500,000; Idaho \$200,000; Oregon \$100,000; and California \$300,000. XYZ Corp. is subject to Oregon and Idaho corporate income tax, but does not owe any California business activities taxes. XYZ does not have any throw-out income because Oregon and Idaho impose a business activities tax on its activities and it is deemed to be taxable in California because it satisfies the minimum nexus standards explained in WAC 458-20-19401 (more than \$250,000 in receipts). XYZ's receipts factor is: $500,000/1,100,000$ or 45.45%.

Example 38. Same facts as Example 37 except Idaho does not impose any tax on XYZ Corp. The \$200,000 attributed to Idaho is throw-out income that is excluded from the denominator because: XYZ Corp. is not subject to Idaho business activities taxes; does not have substantial nexus with Idaho under Washington standards; and performs in Washington at least part of the activities related to the receipts attributed to Idaho. The receipts factor is $500,000/900,000$ or 55.56%.

Example 39. The same facts as Example 38 except XYZ Corp. performs no activities in Washington related to the \$200,000 attributed to Idaho. In this situation, the \$200,000 is not throw-out income and remains in the denominator. The receipts factor is: $500,000/1,100,000$ or 45.45%.

PART 5. HOW TO DETERMINE WASHINGTON TAXABLE INCOME.

(501) General. Washington taxable income is determined by multiplying apportionable income by the receipts factor for each apportionable activity the taxpayer engages in. While the receipts factor is calculated without regard to deductions authorized under chapter 82.04 RCW, apportionable income is determined by reducing the apportionable receipts by amounts that are deductible under chapter 82.04 RCW regardless of where the deduction may be attributed. This formula can be expressed algebraically as:

$$\begin{array}{l} \text{(Taxable} \\ \text{Income)} \end{array} = \begin{array}{l} \text{(Receipts} \\ \text{Factor)} \end{array} \times \begin{array}{l} \text{(Apportionable} \\ \text{receipts -} \\ \text{deductions)} \end{array}$$

Example 40. Calculating apportionable income. Corporation A received \$2,000,000 in apportionable receipts from its worldwide apportionable activities, which included \$500,000 of receipts that are deductible under Washington law. Corporation A's total apportionable income is \$1,500,000 (\$2,000,000 minus \$500,000 of deductions). If Corporation A's receipts factor is 31.25%, then its taxable income is \$468,750 (\$1,500,000 multiplied by 0.3125).

PART 6. REPORTING INSTRUCTIONS.

(601) General.

(a) Taxpayers required to use this rule's apportionment method may report their taxable income based on their apportionable income for the reporting period multiplied by the receipts factor for the most recent calendar year the taxpayer has available.

(b) If a taxpayer does not calculate its taxable income using (a) of this subsection, the taxpayer must use actual current calendar year information.

(602) **Reconciliation.** Regardless of how a taxpayer reports its taxable income under subsection (601)(a) or (b) of this rule, when the taxpayer has the information to determine the receipts factor for an entire calendar year, it must file a reconciliation and either obtain a refund or pay any additional tax due. The reconciliation must be filed on a form approved by the department. In either event (refund or additional taxes due), interest will apply in a manner consistent with tax assessments. If the reconciliation is completed prior to October 31st of the following year, no penalties will apply to any additional tax that may be due.

[Statutory Authority: RCW 82.32.300, 82.01.060(2), 82.04.067, 82.04.460, and 82.04.462. WSR 15-04-004, § 458-20-19402, filed 1/22/15, effective 2/22/15. Statutory Authority: RCW 82.04.067, 82.32.300, and 82.01.060(2). WSR 13-22-044, § 458-20-19402, filed 10/31/13, effective 12/1/13. Statutory Authority: RCW 82.32.300 and 82.01.060(2). WSR 12-19-071, § 458-20-19402, filed 9/17/12, effective 10/18/12.]

APPENDIX B



State of California
Franchise Tax Board

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12.31.15

Chief Counsel Ruling 2015-03

Dear Ms. *****

You requested a Chief Counsel Ruling on the application of market-based sourcing rules for non-marketing services under California Revenue and Taxation Code section ("Revenue and Taxation Code section 25136 and California Code of Regulations ("Regulation") section 25136-2¹. Specifically, you requested the following rulings:

(1) Where both the taxpayer's customer and the taxpayer's customer's customers receive the benefit of a service, the assignment rules for sales of a service should be similar to the rules of assigning sales of marketing and non-marketing intangibles. In other words, sales of services where the taxpayer's services do not market a product, service or other item are properly considered a non-marketing service, and, as a result, should be assigned to the location of the taxpayer's customer and not to the location of the taxpayer's customer's customers. Because the taxpayer's services do not market a product, service or other item, ***** requests that its sales of services be considered non-marketing services and assigned to the location of the taxpayer's customer.

(2) Where the location of where the benefit of the service is received is identifiable and measurable by the Central Processing Unit ("CPU")² usage of the taxpayer's customer as indicated by the taxpayer's books and records kept in the regular course of business, the

¹ Unless otherwise specified, all section references are to the California Revenue and Taxation Code and all Regulation references are to the California Code of Regulations, title 18.

² CPU is a standard term in information technology and refers to the area of the computer system that carries out the functions of the computer, to perform the basic arithmetical, logical, and input/output operations of the system. CPU plays a role somewhat analogous to the brain in the computer and refers to how much work the computer is doing to produce the required output.

taxpayer should be able to use this proxy for determining the location and measure of the benefit received by the taxpayer's customers in this state when the taxpayer cannot reasonably extrapolate data from its financial records maintained in the regular course of business to determine the location and measure of the benefit of the service received by the taxpayer's customers in this state.

FACTS

The taxpayer represents the following facts:

***** or "Taxpayer") is a service provider engaged in the business of providing integrated financial information and analytical applications to its global investment community business entity customers who in turn provide financial services to their business entity customers. By consolidating content from hundreds of databases and then providing the ability to analyze that data, ***** applications offer ***** customers one-stop access to real-time news and quotes, company and portfolio analyses, multi-company comparisons, industry analysis, company screening, portfolio optimization and simulation, predictive risk measurements, alpha-testing, and tools to value and analyze fixed income securities and portfolios. A key component of ***** service offerings to its customers is ***** ability to rapidly and efficiently process substantial volumes of data on its computer-based network and systems for its business entity customers' use.

***** customers are typically portfolio managers, market research and performance analysts, risk managers, marketing professionals, sell-side equity researchers, investment bankers, and fixed income professionals. These customers use ***** for various reasons including performing portfolio attribution analyses, quantitative analyses, and other analytics necessary to manage their portfolios or to create product offerings for their own customers. ***** customers use ***** to manage risk, make better management decisions, and increase productivity. ***** has customers who can have numerous users of ***** services.

***** customers have different use patterns based on the type of user. For example, investment managers will typically be a heavy user of ***** analytical applications, accessing databases and consolidating volumes of worldwide data for long periods of time. An investment manager might wish to compare his portfolio against a certain set of criteria. As such, he or she would use ***** to obtain financial data for companies that have particular characteristics such as all manufacturers located in the Northeastern United States with revenues, gross margins and debt ratios within certain parameters. The application would then scan literally thousands of databases to locate companies that meet the profile, extract the data points that the customer requested, compile the information in a

usable format, perform analytics such as comparisons to industry averages, and then perform further searches for follow up information for which the ***** customer wants to drill down. In contrast, investment bankers would typically be light users, looking for a specific piece of information about a particular company, accessing only fundamental data relative to that specific company and then using that information to assist him or her in providing the right service to the banker's clients. Light users require less computing power because fewer resources are accessed for one item of information for one company than that needed for access to and consolidation of worldwide databases for multiple pieces of information on numerous companies.

***** assigns a User ID to each user. Customers provide a work location for each user when they sign up for the service. When users access ***** services, ***** can track the amount of processing power or CPU that is used, and match that usage to the geographic location associated with that user ID. Thus, CPU usage is a measure of computing and processing power required for ***** to provide services to its users. As stated above, the CPU used to provide services to investment managers, who spend more time using ***** more sophisticated applications, is far greater than that used to provide services to investment bankers, who generally spend less time using more basic functions. In other words, ***** receives higher fees from investment managers and other customers that are heavy users of the computing power than it receives from investment bankers. ***** has the ability to track the amount and location of CPU usage by user ID. ***** books and records kept in the regular course of business reflect that CPU usage is relative to the fees received by ***** from its customers.

As a result of ***** services, ***** customers are more efficient and productive, and have a greater ability to analyze in detail complex data. ***** services to its customers allows ***** customers to provide enhanced service and product offerings to their own customers, thereby making ***** services also beneficial to ***** customer's customers.

***** does not have the resources to extrapolate financial data from its books and records kept in the regular course of its business in order to obtain the necessary financial data for each customer to determine the location and measure of the benefit of the service received by each customer in this state.

ISSUES

(1) Whether, under market based sourcing rules under Revenue and Taxation Code section 25136 and Regulation section 25136-2, sales from a non-marketing service should be sourced to this state to the extent ***** customer receives the benefit of the service in this state or sourced to this state to the extent the taxpayer's customer's customer receives the benefit of the service in this state.

(2) Whether, under market based sourcing rules under Revenue and Taxation Code section 25136 and Regulation section 25136-2, CPU data from a taxpayer's books and records kept in the regular course of business that indicate the location and extent of the benefit of the service received by a taxpayer's customer in this state is a reasonable proxy of the financial data in the taxpayer's books and records kept in the regular course of business that cannot be reasonably extrapolated to determine the location and extent of the benefit of the service received by the taxpayer's customers in this state.

HOLDING FOR ISSUE (1)

For purposes of assigning sales of non-marketing services under Revenue and Taxation Code section 25136 and Regulation section 25136-2, ***** shall assign the sales of its services to this state to the extent its customers and *not* its customer's customers receive the benefit of the service in this state.

HOLDING FOR ISSUE (2)

For purposes of assigning sales of non-marketing services under Revenue Taxation Code section 25136 and Regulation section 25136-2, ***** may use CPU data from its books and records kept in the regular course of business as a reasonable proxy for financial data in the taxpayer's books and records kept in the regular course of business that cannot be reasonably extrapolated to determine the location and extent of the benefit of the service received by the taxpayer's customers in this state.

APPLICABLE LAW

Sales from services are in this state to the extent the purchaser of the service receives the benefit of the service in this state. Revenue and Taxation Code section 25136(a)(1). "To the extent" means that if a customer of a service receives the benefit of a service or uses intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property are included in the numerator of the sales factor according to the portion of the benefit of the services received and/or the use of the intangible property in this state. Regulation section 25136-2(b)(8). The benefit of a service is received in the location where taxpayer's customer has either directly or indirectly received value from delivery of that service. Regulation section 25136-2(b)(1).

Regulation section 25136-2 proscribes cascading rules to determine the sourcing of service fees depending upon whether a taxpayer's customers are individuals or business entities. Regulation section 25136-2(c). In the case where a corporation or other business entity is the taxpayer's customer, the first and pertinent cascading rule provides that the benefit of the service shall be determined as follows:

- (A) The location of the benefit of the service shall be presumed to be received in this state to the extent the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records kept in the regular course of business, notwithstanding the billing address of the taxpayer's customer, indicate the benefit of the service is in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board by showing, based on a preponderance of the evidence, that the location (or locations) indicated by the contract or the taxpayer's books and records was not the actual location where the benefit of the service was received. Regulation section 25136-2(c)(2)(A).

In some situations, the location where the benefit of the service is received might actually be the location of the customers of the taxpayer's customer who directly benefit from the taxpayer's services. The above-referenced statute and regulation do not specify when a sale of a service should be assigned to a taxpayer's customer or when the sale of a service should be assigned to an ultimate customer (the taxpayer's customer's customer.) While there are a number of examples in Regulation section 25136-2 that illustrate how to apply the basic cascading rules for assigning the sale of a service, there are no examples which address assigning the sale of a service where the service gives value to the taxpayer's customer by its use in the customer's business, but which service also adds value to the services provided by the taxpayer's customer to its own customers. However, there are provisions in the regulation addressing the sale of the licensing of intangible property, and those provisions provide guidance to this analogous situation.³ Regulation section 25136-2(d)(2).

Regulation 25136-2(d)(2) distinguishes between the sale of a marketing intangible and the sale of a non-marketing intangible. Under the general definitions section of the regulation, a "marketing intangible" includes the license of an intangible where the value lies predominantly in the marketing of the intangible property in connection with goods, services or other items. Regulation section 25136-2(b)(4)(A). "Marketing" is defined as the action or business of promoting and selling products or services, including market research and advertising. (Oxford Dictionaries. Oxford University Press, n.d. Web. 02 April 2014.) A "non-marketing and manufacturing intangible" includes the license of an intangible to be used in a manufacturing or other non-marketing process, where the value of the intangible property lies predominately in its use in such process. Regulation section 25136-2(b)(4)(B).

The initial cascading rule applicable to the sale of the licensing marketing intangibles provides in relevant part:

³ It should be noted that there is a difference in the assignment rules for sales of services and for sales of intangible property. For sales of services, the assignment rule is the location of where the benefit of the services is received. For sales of intangible property, the assignment rule is the location of the use of the intangible property.

Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items, the royalties or other licensing fees paid by the licensee for such right(s) are attributable to this state to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by the ultimate customers in this state. The contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the regular course of business shall be presumed to provide a method for determination of the ultimate customers... Regulation section 25136-2(d)(2)(A)1.

The initial cascading rule applicable to the sale of the licensing of non-marketing and manufacturing intangibles provides in relevant part:

Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, the licensing fees paid by the licensee for such right(s) are attributable to this state to the extent that the use for which the fees are paid takes place in this state. The terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business shall be presumed to provide a method for determination of the extent of the use of the intangible property in this state... Regulation section 25136-2(d)(2)(B)1.

The examples in Regulation section 25136-2 that address assignment of "marketing intangibles" all relate to intangible property that is involved in selling or promoting a company's products or service. Conversely, the examples in the regulation relating to "non-marketing intangibles" do not relate to selling or promoting a company's products or service. In connection with sales of services, only the Web Corp example addresses assignment of the benefit of the service to the taxpayer's customers' customer. In that example, Web Corp provides internet content to its viewers and receives revenue from providing advertising services to other businesses. The advertisements are shown via the website to Web Corp viewers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website. Web Corp's customers are the advertisers, and its advertising services are marketing services. The example explains that the sales from Web Corp's services are sourced to the location from which the advertisement is viewed and/or clicked on by viewers of the website, which is the location of the ultimate customer. Regulation section 25136-2(c)(2)(E), Examples 4. & 5.

Lastly, Regulation section 25136-2(g)(1) provides that:

In assigning sales to the sales factor numerator pursuant to Revenue and Taxation Code section 25136(b), the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information, as well as the resources of the

taxpayer seeking to obtain this information, and may accept a reasonable approximation when appropriate, such as when the necessary data of a smaller business cannot be reasonably developed from financial records maintained in the regular course of business."

DISCUSSION - ISSUE 1

Revenue and Taxation Code section 25136 and Regulation section 25136-2 do not specify how to determine where the benefit of the service is received for a non-marketing service where both the taxpayer's customer and the taxpayer's customer's customers receive a benefit from use of the service in the taxpayer's customer's business operations.

In the context of a sale in connection with the licensing, leasing, rental or other use of intangible property, the rules in Regulation section 25136-2(d)(2) provide guidance in the analogous situation for the sale of services. Specifically, Regulation section 25136-2(d)(2) makes a distinction between "marketing" and "non-marketing" intangibles whereby a marketing intangible is sourced to the location of the ultimate consumer, but a non-marketing intangible is sourced to the location where the customer uses the intangible in its business. Using this same approach to sales of services would be consistent with the Web Corp example under Regulation 25136-2(c)(2)(E), Example 4. and Example 5.

In applying the guidance for assignation of sales of "non-marketing" intangibles to assignation of sales "non-marketing" services, sales from these services would be sourced to the location where the taxpayer's customer receives a benefit of the service through its use in the business. As is true for a non-marketing intangible, the value of a non-marketing service lies not in the advertising or promoting of a product, service or other item, but rather the value lies in the service being used in the business operations of the taxpayer's customer. ***** web-based service of providing integrated financial information and analytical applications to its customers is not a marketing service used to sell, promote, or advertise its customer's product, service or other item. Rather, ***** service is analogous to a non-marketing intangible that is used in its customers' business operations. Therefore, similar to the assignment rules for sourcing non-marketing intangibles, ***** sales receipts for non-marketing services should be sourced to the this state to the extent its customers receive the benefit of the service in this state.

DISCUSSION - ISSUE 2

Regulation section 25136-2 does not specify which data from a taxpayer's books and records is permissible to determine where the benefit of the services is received by a customer. The regulation specifically excludes the customer's billing address as being indicative of the location where the customer received the benefit of the service.

***** services are used by its customers at the location(s) where the customer accesses ***** services. In other words, the location of the customer (e.g. business or home office) is where the benefit of the service is received. To measure the benefit of the service received, ***** measures each customer's relative CPU usage at the work location(s) provided by the taxpayer for its customer(s) using the User ID assigned to that customer. Those customers who have complicated and sophisticated needs for their business operations using ***** services, i.e. an investment manager who accesses thousands of databases and analytical applications for long periods of time, incur higher CPU usage than a customer using only basic services from ***** i.e. an investment banker who needs one piece of information in connection with one company accessing fewer databases for a lesser period of time. Because of the greater computing power needed by this type of customer, the benefit of the service for more sophisticated customers is greater than the benefit of the service for the basic-need customer. ***** books and records kept in the regular course of business indicate that CPU usage directly correlates with the fees received by ***** from its customers. In other words, a customer who is a heavy CPU consumer pays correspondingly higher fees to ***** For these reasons, CPU usage is a reasonable indicator of the location and extent of the benefit of the service received by the taxpayer's customers.

***** does not have the ability or resources to reasonably develop data from financial records maintained in its regular course of business to determine the location of the benefit received by each customer of the taxpayer. The CPU usage stored in the taxpayer's books and records kept in the regular course of business is an acceptable proxy for financial data that cannot be reasonably extrapolated from the taxpayer's books and records kept in the regular course of business to determine the location and measure of the benefit of the service received by the taxpayer's customers in this state.

***** may assign sales of non-marketing services to the location where its customers receive the benefit of the service as identified and measured by relative CPU usage stored in the taxpayer's books and records kept in the regular course of business.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code.

Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Melissa Williams
Tax Counsel IV

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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