



Service Income Apportionment

The apportionment of service income allows businesses to divide their taxable revenue and their taxes proportionately among the Washington cities in which they do business. Businesses that report revenue under the classification of "Service and Other Business Activities" on their City of Port Townsend business tax return will calculate apportionment of this revenue.

Examples of businesses that report service income include accountants, lawyers, architects, engineers and many other professional service firms. If any of these businesses serve customers within the City of Port Townsend and/or in other Washington cities, they will calculate how that service income should be apportioned.

If your business does not have income to report under the classification of "Service and Other Business Activities," you will not calculate apportionment. Please note that income from intangibles, such as royalties, are not included in the apportionment calculation even though they are reported in that same category. Income from intangibles is sourced to the taxpayer's domicile (headquarters).

What's new?

The method used to apportion service revenue between jurisdictions was changed to comply with the Revised Code of Washington 35.102.130 under House Bill 1403. This method utilizes a market-based sourcing approach to determine how taxable service income is divided amongst multiple jurisdictions. Essentially, the new apportionment method redefines "customer location" for purposes of apportionment.

Customer Location

To calculate service income apportionment, it will be important to have record of the customers' location. The definition of "customer location" depends on whether the customer is a business.

For customers engaged in business, the "customer location" is:

1. Where the services are ordered from;
2. The customer's billing/ mailing address, if the location from which the services are ordered is not known; or
3. At the customer's commercial domicile if none of the above is known.

For customers who are not engaged in business, a homeowner for example, the "customer location" is:

1. If the service requires the customer to be present, it is where the service is performed;
2. If the customer is not required to be physically present, it is the customer's residence; or if the location of the customer's residence is not known, it is the customer's billing/ mailing address.

Information you will need

Before you begin to calculate the apportionment of your service income, gather the following information:

- Total service receipts
- Total service payroll costs
- Total Port Townsend service payroll costs
- Location of each of your customers (see definition above)

Calculating the Service Income Apportionment

You can calculate service income apportionment using our Service Income Apportionment Workbook when you file your B&O Tax Return.

Examples

Example 1: An individual with health insurance seeks medical services at a doctor's office in Port Townsend. The individual is the customer for purposes of determining customer location even though the individual may utilize their insurance to pay for the medical services provided to them. The individual is required to be present at the doctor's office to receive the services, therefore the service receipts are sourced to the location of the doctor's office where the services are performed.

Example 2: AA Architecture provides architectural and engineering design plans for residential homeowners in Washington, Oregon and Idaho. Homeowners mail pictures of their home to AA Architecture, and AA Architecture delivers plans and projected work plans to the customer. AA Architecture uses a purchased commercial software tool that allows it to develop plans on computers. The software tool is a DAS. The tool is only used by AA Architecture's employees; its customers cannot use these tools. All client deliverables are provided in physical format (i.e., paper documents); at no time are the plans transferred electronically. AA Architecture reports under the services and other activities classification and has its only business location in Port Townsend. Because AA Architecture's service does not require the customer to be physically present and their customers are not engaged in business, AA Architecture would source their receipts first to the customer's residence. Only if the customer's residence is not known, AA Architecture would source their receipts to the customer's billing/mailing address.

Example 2A: Assume the same facts as Example 2, except that AA Architecture will email deliverables to those homeowner clients that request receipt via electronic email. Per Washington Department of Revenue (DOR) interim guidance for Engrossed Substitute Senate Bill (ESSB) 5814, this would result in the same result as Example 2 as the mere use of email to communicate the result of the professional service would not require reporting income as retailing (retailing cannot be apportioned).

Example 2B: Assume the same facts as Examples 2 and 2.A, except that AA Architecture purchased a commercial software tool that permits homeowner clients to obtain their plans by accessing an internet portal and does not charge homeowner clients to use the portal so that the cost of the plan design service does not change and the cost of the service is known at the time of sale. Even though the internet portal is a DAS, per DOR interim guidance for ESSB 5814, because the homeowner clients do not use the DAS portal to perform the professional services themselves, the price of the service is known at the time of sale and does not vary based upon the method of delivery, the DAS portal is not marketed and available for purchase, and there is no charge for the DAS portal, this would result in the same results as Examples 2 and 2.A. In other words, the use of the DAS portal by AA Architecture to merely deliver the result of its professional services would not require reporting income as retailing (retailing cannot be apportioned).

Example 2C: Assume the same facts as Examples 2, 2.A, and 2B, except that AA Architecture's homeowner clients can use the plan development software tool to create and edit plans and documents that are then reviewed by an AA Architecture employee for an upfront agreed upon fee. The software is a DAS. AA Architecture is selling a DAS because the service is, at least in part, transferred electronically using one or more software applications (i.e., the software tool used to draft the plans). Since there is no exclusion for a DAS conducted using human effort, primarily or otherwise, AA Architecture will report the sale under the retailing classification, which cannot be apportioned.



Example 3: CC Consulting Co. provides consulting services to customers engaged in business throughout Washington. CC Consulting Co. maintains billing address information for all its customers. In addition, CC Consulting Co. also has information about the location from which the services are ordered, contracts, invoices, and other communication with the customer. CC Consulting Co. must follow sourcing hierarchy for sourcing service receipts to the customer location. CC Consulting Co. would first determine the location from which the services are ordered; if the location from which the services were ordered was not known, CC Consulting Co. would use the customer’s billing or mailing address; and finally, if CC Consulting Co. did not know its customer’s billing or mailing address, CC Consulting Co. would source the service income to the customer’s place of domicile or where it is headquartered. In this example, CC Consulting Co. has information in its business records to identify the location from which the services were ordered. Therefore, CC Consulting Co. will source its service receipts to the location from which services were ordered and will not use the customer billing addresses.

Example 4: AA Architecture is located in Tacoma, Washington and provides architectural services to customers engaged in business throughout Washington State. SS Software Co., a software company located in Port Townsend, contracts with AA Architecture to draft plans to renovate their branch office in Bellevue. The order was made by SS Software Co. personnel located in Port Townsend. AA Architecture will source the SS Software Co. service receipts to Port Townsend, the location from which the services were ordered.

Example 5: BB Bookkeeping, LLC is a bookkeeping company that provides bookkeeping services to customers engaged in business throughout Washington State. Huge Software Co. contracts with BB Bookkeeping, LLC to provide bookkeeping services for their branch office in Port Townsend. The services were ordered from the branch office in Port Townsend and approved by the company’s main office and procurement department in Bellevue. BB Bookkeeping will source Huge Software Co. service receipts to Port Townsend, the location from which the services were ordered and not from where the order was approved.

Example 6: SS Services, LLC reports under the service classification and has its only business location in Port Townsend. SS Services, LLC has employees but also maintains contracts with independent contractors who sell the company’s services. The independent contractors are paid by commission. The independent contractors are located partly outside of the state and partly within the state. SS Services, LLC employs managers who visit the independent contractors but are assigned to the Port Townsend office. SS Services, LLC has nexus outside of the state due to their independent contractors working with SS Services, LLC’s ultimate customer. SS Services, LLC should compute their taxable service income using the two-factor method. Since their employees and the traveling managers are assigned to the Port Townsend office, 100% of the payroll is assigned to Port Townsend. If 75% of the service income is attributable to customer locations outside of Port Townsend and 25% inside of Port Townsend (PT), then the two-factor apportionment would be as follows:

$$\text{Apportionment Factor} = \frac{100\% \text{ (PT payroll factor)} + 25\% \text{ (PT income factor)}}{2} = \frac{125\%}{2} = 62.5\%$$

Example 6A: Assume the same facts as Example 6, however 10 percent of SS Services, LLC’s sales are attributable to cities in which SS Services, LLC is “not taxable” (the taxpayer is not subject to a business activities tax and the taxpayer is not deemed to have substantial nexus in the customer location). Furthermore, some of the service activity is performed in Port Townsend. As a result, 10 percent of SS Services, LLC’s sales must be excluded from the income factor denominator. Therefore, the service apportionment factor and the two-factor apportionment would be as follows:

$$\begin{aligned} \text{Service Activity Income Factor} &= \frac{25\% \text{ (PT income factor)}}{100\% \text{ (Worldwide service activity income)} - 10\% \text{ (Excluded income)}} = \frac{25\%}{90\%} = 27.8\% \\ \text{Apportionment Factor} &= \frac{100\% \text{ (payroll factor)} + 27.8\% \text{ (20/90 Service income factor)}}{2} = \frac{127.8\%}{2} = 63.9\% \end{aligned}$$



Example 7: EE Engineering Co. provides engineering consulting services to businesses. EE Engineering Co. has offices in Port Townsend, Bellingham and Tacoma. EE Engineering Co’s service income is attributed 40-percent in Port Townsend, 40-percent in Bellingham, and 20-percent in Tacoma. Their office staffing is 60-percent in Port Townsend, 30-percent in Bellingham and 10-percent in Tacoma. Projects are shared among the various offices. Staff working on a project may sit in one office and report to a specialist and managers that are in different offices. Therefore, some of the service activity is performed in all of EE Engineering Co’s offices. The service income apportionment factor and two-factor apportionment would be as follows:

Port Townsend Apportionment Factor	=	$\frac{60\% \text{ (PT payroll factor)} + 40\% \text{ (PT income factor)}}{2}$	=	$\frac{100\%}{2}$	= 50.0%
Bellingham Apportionment Factor	=	$\frac{30\% \text{ (B'ham payroll factor)} + 40\% \text{ (B'ham income factor)}}{2}$	=	$\frac{70\%}{2}$	= 35.0%
Tacoma Apportionment Factor	=	$\frac{10\% \text{ (Tacoma payroll factor)} + 20\% \text{ (Tacoma income factor)}}{2}$	=	$\frac{30\%}{2}$	= 15.0%

Example 7A: Assume the same facts as Example 7, however EE Engineering Co. only has offices in Port Townsend and Tacoma. EE Engineering Co’s service income is 50-percent in Port Townsend, 30-percent in Tacoma, and 20-percent in Fife. Their office staffing is 40-percent in Port Townsend and 60-percent in Tacoma. EE Engineering Co. is “not taxable” in Fife because Fife does not impose a business activities tax, and the taxpayer is not deemed to have a substantial nexus in Fife. Fife customers travel to the Tacoma office for business meetings with EE Engineering Co. and projects are shared among the various offices. Staff working on a project may sit in one office and report to a specialist and managers that are in different offices. Therefore, some of the service activities are performed in all of EE Engineering Co’s offices. The service income apportionment factor and the two-factor apportionment would be as follows:

Port Townsend Service Income Factor	=	$\frac{50\% \text{ (Service income)}}{100\% \text{ (Worldwide service income)} - 20\% \text{ (Excluded income)}}$	=	$\frac{50\%}{80\%}$	= 62.5%
Port Townsend Apportionment Factor	=	$\frac{40\% \text{ (PT payroll factor)} + 62.5\% \text{ (50/80 service income factor)}}{2}$	=	$\frac{102.5\%}{2}$	= 51.3%
Tacoma Service Income Factor	=	$\frac{30\% \text{ (Service income)}}{100\% \text{ (Worldwide service income)} - 20\% \text{ (Excluded income)}}$	=	$\frac{30\%}{80\%}$	= 37.5%
Tacoma Apportionment Factor	=	$\frac{60\% \text{ (Tacoma payroll factor)} + 37.5\% \text{ (30/80 Service income factor)}}{2}$	=	$\frac{97.5\%}{2}$	= 48.8%



Example 7B: Assume the same facts as Example 7 and 7.A, except all work is done in the Port Townsend office and the Tacoma office handles the administrative operations of the business. EE Engineering Co. has nexus in Tacoma because of the presence of the office. However, because none of the work is done in Tacoma, none of the Fife income would be excluded from the service income factor for Tacoma. The service income apportionment factor and the two-factor apportionment would be as follows:

Port Townsend Service Income Factor	=	$\frac{50\% \text{ (Service income)}}{100\% \text{ (Worldwide service income)} - 20\% \text{ (Excluded income)}}$	=	$\frac{50\%}{80\%}$	=	62.5%
Port Townsend Apportionment Factor	=	$\frac{40\% \text{ (PT payroll factor)} + 62.5\% \text{ (50/80 service income factor)}}{2}$	=	$\frac{102.5\%}{2}$	=	51.3%
Tacoma Service Income Factor	=	$\frac{30\% \text{ (Service income)}}{100\% \text{ (Worldwide service income)}}$	=	$\frac{30\%}{100\%}$	=	30.0%
Tacoma Apportionment Factor	=	$\frac{60\% \text{ (Tacoma payroll factor)} + 30.0\% \text{ (30/100 Service income factor)}}{2}$	=	$\frac{90.0\%}{2}$	=	45.0%