Cite as Det. No. 16-0026, 37 WTD 201 (2018)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	DETERMINATION
	)	No. 16-0026
. . .	)	Registration No. . . .

[1] RCW 82.04.2907: ROYALTIES B&O TAX – CREDIT CARD PROCESSING: While Issuer "members" were granted the additional right to issue ATM cards to individual cardholders bearing Taxpayer's brand name, we conclude that the access to Taxpayer's System granted through the "membership agreement" indicates these were not agreements related to some intangible right such as a license, trademark, or "similar item," but for "membership" and access to a payment system that was vital to the business activity of Taxpayer's customers. As such, we conclude that Taxpayer's business activity – to the extent we deem such activity taxable in Washington – is properly classified under the "catch-all" service and other activities B&O tax classification pursuant to RCW 82.04.290(2).

[2] RCW 82.04.067; COMMERCE CLAUSE OF UNITED STATES CONSTITUTION, *COMPLETE AUTO*; DUE PROCESS CLAUSE OF UNITED STATES CONSTITUTION: B&O TAX – NEXUS: Where receipts attributed to Washington exceeded the receipts threshold under RCW 82.04.067(1)(c)(iii), Taxpayer established substantial nexus with Washington under the first prong of *Complete Auto*. Such receipts for providing authorization, clearing, and settlement services on ATM card transactions occurring at ATM machines located in Washington, is an activity "purposefully directed" toward Washington residents that establishes the minimum contacts with Washington that are necessary for taxation under the Due Process Clause.

[3] WAC 458-20-19402 ("Rule 19402"); RCW 82.04.462: B&O TAX – ATTRIBUTION – BENEFIT OF SERVICE – LOCATION OF CUSTOMERS RELATED BUSINESS ACTIVITIES: Both the Issuers' and the Acquirers' related business activities occur at the location where the "swipe" of the ATM card occurs. That "swipe" location is the location of the ATM machine, or equivalent service, where the individual cardholder is using the Issuer's authorization of cash withdrawal, and is also the location at which the Acquirer completes the ATM card transaction on its ATM machine. We, therefore, conclude that the ATM machine location is a reasonable method for attributing Taxpayer's gross income under RCW 82.04.462(3)(b)(i) and Rule 19402(301)(a)(i).

> [4] RULE 228; RCW 82.32.105: PENALTIES – WAIVER – CIRCUMSTANCES BEYOND CONTROL – MISUNDERSTANDING – "REASONABLE EFFORTS TO COMPLY WITH THE FILING REQUIREMENTS": Rule 228 does not provide relief if a taxpayer has a "reasonable basis" for its filing position. The Department has consistently held that lack of knowledge of Washington's tax obligations does not constitute circumstances beyond the control of the taxpayer. *See e.g.* Det. No. 05-0174, 25 WTD 48 (2006) (holding that out-of-state business' good-faith belief that it was not required to register and pay Washington taxes is not a circumstance beyond the control of the taxpayer); Det. No. 06-0088, 26 WTD 201 (2007) (holding lack of knowledge of Washington tax obligation is not grounds for waiver).

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

Yonker, A.L.J. – An out-of-state automated teller machine (ATM) card transaction processor (Taxpayer) protests the assessment of business and occupation (B&O) tax in Washington on various grounds, including (1) that some of its gross income should have been classified under the royalties tax classification; (2) the Department's taxation of Taxpayer's gross income is unconstitutional; and (3) if constitutional, the Department's taxation of Taxpayer's gross income was based on an improper attribution method. The petition is denied.[1]

ISSUES

1. Is gross income from "card service fees" properly classified under the service and other activities B&O tax classification pursuant to RCW 82.04.290(2) or the royalties B&O tax classification pursuant to RCW 82.04.2907?

2. Did Taxpayer have nexus with Washington pursuant to the Commerce Clause and Due Process Clause of the U.S. Constitution, and RCW 82.04.067, where Taxpayer had over $250,000 in receipts from Washington?

3. [P]ursuant to RCW 82.04.462 and WAC 458-20-19402, [did the Department properly] attribute Taxpayer's gross income to Washington based on the location of ATM machines from which cash withdrawals were processed through Taxpayer's nationwide payment system?

4. Is Taxpayer entitled to a waiver of penalties under RCW 82.32.105 and WAC 458-20-228?

FINDINGS OF FACT

. . . (Taxpayer) is [an out-of-state] corporation in the business of (1) operating and administering "an electronic switching system" that provides ATM services and (2) administering an electronic funds transfer (EFT) "switching network" to financial institution "members." The system that accomplishes these activities is called . . . (System). Taxpayer is a subsidiary of . . . , and essentially

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[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

serves as that company's electronic funds transfer (EFT) point-of-sale national "ATM card" transaction processor. Taxpayer provides such ATM card processing services from data centers located outside of Washington. Taxpayer's customers consist of two categories of financial institutions: (1) the "Issuers," which are financial institutions that issue ATM cards bearing Taxpayer's brand; and (2) the "Acquirers," which are financial institutions from whose ATM machine a cardholder is requesting a cash withdrawal.[2]

At the heart of every ATM card transaction is a cardholder who wishes to withdraw cash from a bank account using an ATM machine, which machine may or may not be operated by the Issuer of the cardholder's ATM card. Taxpayer, Issuers, and Acquirers all play necessary roles in the processing and completion of individual ATM card transactions through the following general steps:

1. A cardholder seeks to withdraw cash from an ATM machine using an ATM card. The cardholder "swipes" the ATM card in the ATM machine and enters the "pin number."

2. The Acquirer, which operates the ATM machine, captures the necessary information to complete the transaction, and requests authorization for the transaction from the Issuer by transmitting such account information and authorization request electronically to Taxpayer's System.[3]

3. Taxpayer's System then "processes" that information and routes it further to the Issuer for authorization of the pending ATM card transaction.

4. The Issuer receives the transaction information from Taxpayer's System and authorizes the transaction based on the information it receives through Taxpayer's System and the cardholder's bank account information, and transmits that authorization decision back through Taxpayer's System. If the purchase is authorized, the Issuer debits the cardholder's bank account.

5. Taxpayer's System "processes" the Issuer's authorization decision and routes it to the Acquirer.

6. The Acquirer transmits the Issuer's authorization decision to the cardholder via the ATM machine. If the Issuer authorized the transaction, the ATM machine issues cash to the cardholder.

All of these steps generally take a matter of seconds to complete. Assuming the transaction was authorized by the Issuer, Taxpayer then facilitates the "clearing" and "settlement" of the ATM transactions between Acquirers and Issuers.

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[2] Throughout this determination, any reference to the ATM machine includes any similar locations that may not technically be considered actual ATM machines, but locations nonetheless that allow a cardholder to use an ATM Card to withdraw cash.

[3] In some ATM card transactions, the Acquirer and the Issuer are the same business entity, in which case, Taxpayer's System is not accessed.

During the time period at issue, Taxpayer derived income from two primary sources. First, Taxpayer received "card service fees" from its customers, who paid such fees pursuant to a "membership agreement" with Taxpayer. An example "membership agreement" provided by Taxpayer stated the following:

> "Applicant" understands that [Taxpayer], a membership corporation . . . has developed and established and is administering an automated teller machine ("ATM") service system . . . utilizing certain service marks and other distinctive indicia . . . to identify and distinguish its services. . . .
>
> As part of and pursuant to its Application, the Applicant hereby agrees to be bound by the terms and conditions of the By-Laws and Operating Regulations of [Taxpayer] . . . .

Thus, by entering into such an agreement, "members" were, as Taxpayer stated, entitled "to access [Taxpayer's] transaction processing systems." In addition, depending on the category of membership, some members also received the privilege of issuing ATM cards to individual cardholders bearing Taxpayer's brand mark. In exchange for these privileges, "members" agreed to comply with the obligations of all members as stated in Taxpayer's bylaws, and to pay "card service fees," which were calculated as a percentage of the total monetary amount of purchases charged by individual cardholders on the Issuer's ATM cards.

Taxpayer's second primary source of income was from "data processing fees" paid both by Issuers and Acquirers for using Taxpayer's System in the processing and completion of individual ATM card transactions. These "data processing fees" were based on the total number of individual ATM card transactions processed through Taxpayer's System. In addition to these two primary sources of income, Taxpayer also receives a small percentage of its total revenue from what Taxpayer recorded as "other revenue" sources, which was a catch-all category that included a variety of relatively small revenue sources.

Quarter Two of 2010 was the first tax period for which Taxpayer filed a combined excise tax return in Washington. From that time through the end of 2012, Taxpayer reported total gross income of $ . . . from "card service fees" attributed to Washington, and $ . . . from "data processing fees" attributed to Washington.[4] Taxpayer attributed its gross income to Washington based on the billing address of the Issuers and Acquirers.

In 2012, the Department's Audit Division commenced a review of Taxpayer's books and records for the period of June 1, 2010, through December 31, 2012 (audit period). Among the findings that the Audit Division made as result of its review, it found that (1) Taxpayer had nexus with Washington, and was, therefore, subject to taxation here, and (2) Taxpayer's gross income should be attributed to Washington based on the location of the ATM card transaction as recorded in the data Taxpayer received from its customers, as opposed to the location of the Issuer and Acquirer billing addresses.

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[4] The Audit Division during its review found that Taxpayer had the following total gross income attributable to Washington: $ . . . in 2010; $ . . . in 2011; and $ . . . in 2012, all of which the Audit Division classified under the service and other B&O tax classification.

On November 18, 2014, as a result of the Audit Division's review, the Department issued a tax assessment against Taxpayer for a total of $ . . . , which included $ . . . in service and other activities B&O tax, a credit of $ . . . for royalties B&O tax already paid, a five-percent assessment penalty of $ . . . and $ . . . in interest. Taxpayer subsequently appealed the tax assessment.

ANALYSIS

Washington imposes a B&O tax on "for the act or privilege of engaging in business" in this state. RCW 82.04.220. The B&O tax "is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.* The B&O tax rate used is determined by the nature of the business activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW.

The B&O tax is "extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State." *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). "Business" is defined broadly to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140.

1. Classification of Gross Income

Generally, if a taxpayer is engaged in an activity "other than or in addition to an activity taxed explicitly" under Chapter 82.04 RCW, that activity is subject to the "catch-all" service and other activities B&O tax. RCW 82.04.290(2)(a). The Audit Division classified all of Taxpayer's gross income under the service and other activities B&O tax classification.

Taxpayer does not dispute that the majority of its gross income at issue, if taxable in Washington, is properly classified under the service and other activities B&O tax classification. However, Taxpayer argues that its gross income from "card service fees" should be classified under the royalties B&O tax classification under RCW 82.04.2907,[5] which stated the following during the audit period:

> (1) Upon every person engaging within this state in the business of receiving income from royalties, the amount of tax with respect to the business is equal to the gross income from royalties multiplied by the rate of 0.484 percent.
>
> (2) For the purposes of this section, "gross income from royalties" means compensation from the use of intangible property, including charges in the nature of royalties, regardless of where the intangible property will be used. For purposes of this subsection, "intangible property" includes copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. "Gross income from

[5] During the course of the audit period, RCW 82.04.2907 was amended, but remained substantially similar to the current version quoted here. Also, effective August 1, 2015, RCW 82.04.2907 was amended yet again, increasing the tax rate from 0.484 percent to the same rate as the service and other activities B&O tax under RCW 82.04.290(2), which is 1.5 percent.

> royalties" does not include compensation for any natural resource, the licensing of prewritten computer software to the end user, or the licensing of digital goods, digital codes, or digital automated services to the end user . . . .

As the statute makes clear, the "intangible property" at issue must be similar to copyrights, patents, licenses, franchises, trademarks, and trade names, in order to qualify.

Here, the "membership agreement" demonstrates that "members" were not merely obtaining a license to use Taxpayer's brand on ATM cards issued to individual cardholders. Instead, the "membership agreement" makes clear that "members" also received access to Taxpayer's System. Without such access, Taxpayer's customers, the Acquirers and Issuers, would not be able to as efficiently complete the authorization, clearing, and settlement phases of an ATM card transaction. While Issuer "members" were granted the additional right to issue ATM cards to individual cardholders bearing Taxpayer's brand name, we conclude that the access to Taxpayer's System granted through the "membership agreement" indicates these were not agreements related to some intangible right such as a license, trademark, or "similar item," but for "membership" and access to a payment system that was vital to the business activity of Taxpayer's customers.

As such, we conclude that Taxpayer's business activity – to the extent we deem such activity taxable in Washington – is properly classified under the "catch-all" service and other activities B&O tax classification pursuant to RCW 82.04.290(2).

2. <u>Nexus in Washington</u>

Taxpayer challenges the constitutionality of Washington's ability to tax Taxpayer's business activity during the audit period. Specifically, Taxpayer states that "[t]he economic nexus provisions in the 2010 Legislation violate [the Commerce Clause and the Due Process Clause of the Fourteenth Amendment]." Preliminarily, we note that to the extent Taxpayer claims that RCW 82.04.067, RCW 82.04.460, or RCW 82.04.462 are "facially" unconstitutional, we lack authority to rule on those issues. *Bare v. Gorton*, 84 Wn.2d 380, 383, 576 P.2d 379 (1974) ("An administrative body does not have the authority to determine the constitutionality of the law it administers; only the courts have that power."); Det. No. 14-0345, 34 WTD 294 (2015). Thus, we make no ruling regarding any facial constitutional challenge Taxpayer raises against any statute.

Notwithstanding the broad definition of "business" under RCW 82.04.140, discussed earlier, which essentially includes all business activities that benefit a taxpayer, a state cannot tax transactions that do not have a sufficient connection, or "nexus," with that state. *See, e.g.*, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L.Ed.2d 326 (1977); *Tyler Pipe Industries, Inc. v. Dep't. of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810 (1987); *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904 (1992). The nexus requirement flows from limits on a state's jurisdiction to tax found in both the Commerce Clause and the Due Process Clause of the United States Constitution. *Quill,* 504 U.S. at 305; *Lamtec Corp. v. Dep't of Revenue,* 170 Wn.2d 838, 246 P.3d 788 (2011) ("A tax on an out-of-state corporation must satisfy the requirements of the due process clause of the Fourteenth Amendment and the commerce clause."). Further, the requirements of the Due Process Clause and the Commerce Clause "pose distinct limits on the taxing powers of the States" and these "two constitutional requirements differ fundamentally, in

several ways." *Quill,* 504 U.S. at 305. For the reasons described below, we find no constitutional violation under either the Commerce Clause or the Due Process Clause to preclude the assessment of B&O tax against Taxpayer in Washington during this latter portion of the audit period.

a. Commerce Clause Requirements for Taxation in Washington

The United States Supreme Court has identified certain requirements under the Commerce Clause for a state to impose a tax on an out-of-state business. In *Complete Auto*, the U.S. Supreme Court articulated a four-pronged test that a state tax must satisfy to withstand a Commerce Clause challenge to its jurisdiction to tax. *Complete Auto,* 430 U.S. at 278-79. The Court held that the Commerce Clause requires that the tax: (1) be applied to an activity with "substantial nexus" with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state. *Id.* at 79. Here, Taxpayer argues that the Department's assessment of B&O tax on Taxpayer violates all four prongs of the *Complete Auto* test.

i. First Prong of the *Complete Auto* Test – Substantial Nexus

The United States Supreme Court has not defined "substantial nexus" or established a specific approach to determining whether that dormant Commerce Clause requirement has been met. The Washington Legislature has attempted to fill that gap by defining "substantial nexus" by statute. A person meeting the statutory definition presumptively satisfies the constitutional requirement.

Effective June 1, 2010, the definition of "substantial nexus," the first prong of the *Complete Auto* test, is codified in Washington under RCW 82.04.067 for apportionable business activities. RCW 82.04.067(6). The express purpose of the economic nexus legislation is to require businesses that "earn 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." Laws of 2010, ch. 23, § 101. RCW 82.04.067(1) provides, in relevant part, that a person engaging in a service activity taxable under RCW 82.04.290 is deemed to have substantial nexus with Washington if the person is:

> (c) A nonresident individual or a business entity that is organized or commercially domiciled outside this state, and in any tax year the person has:
>
> (i) More than fifty thousand dollars of property in this state;
>
> (ii) More than fifty thousand dollars of payroll in this state;
>
> (iii) More than two hundred fifty thousand dollars of receipts from this state; or
>
> (iv) At least twenty-five percent of the person's total property, total payroll, or total receipts in this state.

Further, RCW 82.04.067(6) makes clear that a taxpayer's physical presence in Washington is required only to establish substantial nexus in cases involving taxpayers that are engaged in business activities that are not apportionable. Thus, so long as Taxpayer satisfies one of the criteria

set forth in RCW 82.04.067(1)(c) during the period from June 1, 2010, to December 31, 2012, it has substantial nexus with Washington.

Here, the Audit Division found that Taxpayer had receipts attributed to Washington [in the amount of] $ . . . in 2010, $ . . . in 2011, and $ . . . in 2012.[6] These figures are significantly higher than $250,000, and, thus, Taxpayer had substantial nexus in Washington pursuant to the "receipts" threshold under RCW 82.04.067(1)(c)(iii). Accordingly, we conclude that Taxpayer had substantial nexus as defined by RCW 82.04.067, and as required under the first prong of the *Complete Auto* test.[7]

ii. Second Prong of the *Complete Auto* Test – Fair Apportionment

Effective June 1, 2010, RCW 82.04.460(1) provides:

> Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

"Apportionable income" means "gross income of the business generated from engaging in apportionable activities." RCW 82.04.460(4)(a). "Apportionable activities," in turn, specifically include those taxed under RCW 82.04.290, the service and other activities B&O tax classification. RCW 82.04.460(4)(a)(vi). Here, Taxpayer provides ATM card payment processing services, which are taxable under RCW 82.04.290. Therefore, Taxpayer is engaged in "apportionable activities" in Washington and, therefore, earned "apportionable income." There is also no dispute that Taxpayer is also taxable in other states. Thus, the income Taxpayer earned from the rendition of its services is subject to apportionment under RCW 82.04.460.

Income apportioned to Washington is multiplied by a single "receipts factor," the numerator of which is the gross income of the business attributed to Washington and the denominator of which is the gross income of the business worldwide. RCW 82.04.462. This was the method employed by the Audit Division to determine Taxpayer's gross income in Washington.

Taxpayer stated on appeal that "[u]nder the internal consistency test, apportionment of the receipts of an out-of-state taxpayer by a single sales factor cannot satisfy the fair relationship test." We

[6] Rule 19401(6)(b) makes clear that for the purpose of determining if a taxpayer has reached the receipts threshold under RCW 82.04.067(1)(c)(iii), the receipts classified under the service and other activities B&O tax classification – as is the case here – are generally attributed to Washington pursuant to Rule 19402. We affirm the method of attributing Taxpayer's receipts to Washington for the purpose of determining whether Taxpayer reached the receipts threshold for establishing substantial nexus. *See infra* Part 2(c) (discussing the Audit Division's process of determining Taxpayer's receipts that were attributed to Washington). As discussed later, we conclude that the Audit Division properly attributed receipts to Washington based on the . . . location of individual [ATMs, or equivalent service, which is the location where the "swipe" of the ATM card occurs].

[7] To the extent that Taxpayer claims RCW 82.04.067 is unconstitutional "as applied," we conclude that Taxpayer has failed to prove that application of the statute "impairs a constitutional right." *See State v. Smith,* 185 Wn. App. 945, 952, 344 P.3d 1244 (2015).

interpret Taxpayer's statement here as a facial challenge to the constitutionality of RCW 82.04.462. As stated earlier, we have no authority to rule on such facial constitutional challenges, and decline to make any ruling in that regard. However, we note that single-factor sales apportionment has been held constitutional under the Commerce Clause. *See Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 273, 98 S.Ct. 2340 (1978).

Taxpayer offered no other argument regarding how the Audit Division's application of the apportionment method under RCW 82.04.462 is unconstitutional. As such, we conclude the Audit Division satisfied the *Complete Auto* requirement of fair apportionment.

iii. Third Prong of the *Complete Auto* Test – No Discrimination Against Interstate Commerce

A tax on interstate commerce is not discriminatory unless it affords a "different tax treatment of interstate and intrastate commerce" that is detrimental to interstate commerce. *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 618 (1981); *Associated Industries of Missouri v. Lohman,* 511 U.S. 641, 652, n. 4 (1994); *Chicago Bridge & Iron Co. v. Dep't of Revenue,* 98 Wn.2d 814, 830, 659 P.2d 463 (1983).

Here, Taxpayer offers no specific argument describing how it believes the B&O tax affords a different tax treatment of interstate and intrastate commerce. Indeed, a plain reading of RCW 82.04.220 reveals that the B&O tax is imposed "for the act or privilege of engaging in business" in Washington, regardless of the location of a taxpayer. Further, the broad definition of "business" under RCW 82.04.140 makes no distinction regarding the location of a taxpayer, only that the "business" activity occurs in Washington. Nor do we find any language declaring a discriminatory tax treatment for taxpayers located outside of Washington in the definition of substantial nexus under RCW 82.04.067 or apportionment under RCW 82.04.462. As such, we reject Taxpayer's claim that the B&O tax discriminates against interstate commerce.

iv. Fourth Prong of the *Complete Auto* Test – Fairly Related to State Services

The purpose of this final prong of the *Complete Auto* test, which requires that a tax be "fairly related to services provided by the state," is to ensure that a state's tax burden is not placed upon persons who do not benefit from services provided by that state. *Goldberg v. Sweet,* 488 U.S. 252, 266-67, 109 S.Ct. 582 (1989) (citing *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 627, 101 S.Ct. 2946 (1981)). Further, a tax imposed on interstate transactions does not need to be limited to the cost of services incurred by a state because of that particular activity; rather, "interstate commerce may be required to contribute to the cost of providing *all* governmental services, included those services from which [a taxpayer] arguably receives no direct 'benefit.'" *Commonwealth Edison,* 453 U.S. at 627. Indeed, such services as "receipt of police and fire protection, the use of public roads and mass transit, and the other advantages of civilized society" satisfy the requirements of this final prong of the *Complete Auto* test. *Goldberg,* 488 U.S. at 267 (citing *D.H. Holmes C. Ltd. v. McNamara,* 486 U.S. 24, 32, 108 S.Ct. 1619 (1988)).

We conclude that Taxpayer receives services in many forms from Washington, including the provision of infrastructure for the processing of ATM card transactions on behalf of its customers.

Taxpayer provides no other specific argument regarding its challenge to the assessment of B&O tax under this final prong of the *Complete Auto* test. Therefore, we conclude the assessment of B&O tax is fairly related to services provided by Washington.

b. Due Process Requirements for Taxation in Washington

In addition to the requirements under the Commerce Clause, a state's taxation of an out-of-state business must also meet two requirements under the Due Process Clause.[8] First, there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill,* 504 U.S. at 306 (citing *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-45, 74 S.Ct. 535 (1954)). Second, "the income attributed to the state for tax purposes must be rationally related to 'values connected with the taxing State.'" *Quill,* 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 273, 98 S.Ct. 2340 (1978)).

With respect to the first requirement, the *Quill* court relied heavily on jurisdiction cases to determine if a taxpayer had "minimum contacts" with the taxing state such that taxing that taxpayer did not offend "traditional notions of fair play and substantial justice." *Quill,* 504 U.S. at 307 (citing *Int'l Shoe Co. v. Washington,* 326 U.S. 310, 316, 66 S.Ct. 154 (1945)).

The *Quill* Court went on to quote its earlier decision in *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985):

> Jurisdiction in these circumstances may not be avoided merely because the defendant did not *physically* enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there."

(Emphasis in original). Thus, the *Quill* decision makes clear that in addition to physical presence, an individual may be subject to personal jurisdiction in a state if any efforts were "purposefully directed" toward residents of that state. *Id.*

Here, Taxpayer receives gross income from its customers for providing authorization, clearing, and settlement services on ATM card transactions occurring at ATM machines located in

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[8] While we decline to rule on Taxpayer's facial constitutional challenge to the "2010 Legislation," we note that that RCW 82.04.067, RCW 82.04.460, and RCW 82.04.462 all relate only to the constitutional requirements under the Commerce Clause, and do not contain any language that purports to do away with, or otherwise alter, the separate Due Process Clause requirements on a state's taxing authority. In other words, even with the passage of the "2010 Legislation," a state may not tax that taxpayer's business activity unless the requirements under the Due Process Clause are independently satisfied as well. Thus, to the extent that Taxpayer challenges the "2010 Legislation" under the Due Process Clause, such challenge appears misplaced.

Washington. This activity is "purposefully directed" toward Washington residents. Thus, we conclude that Taxpayer had the minimum contacts necessary with Washington.

Taxpayer argues, however, that in order to satisfy the Due Process requirements for a state to tax an out-of-state business, the business must be "essentially at home in the forum state." *See Daimler AG v. Bauman,* 134 S.Ct. 746 (2014) (holding that plaintiffs could not bring suit in California against a foreign corporation when the lawsuit was unrelated to that corporation's in-state contacts because the corporation did not have general jurisdiction in California). In other words, Taxpayer's position appears to be that "general" jurisdiction, as opposed to "specific" jurisdiction, is necessary to satisfy the Due Process Clause. We disagree. Taxpayer's argument is in direct conflict with state taxation cases such as *Quill*, which make clear that only "minimum contacts," or specific jurisdiction, is required to satisfy this first requirement of the Due Process Clause, as opposed to general jurisdiction.[9] *See also Lamtec Corp.,* 170 Wn.2d at 843-44 ("The due process inquiry considers whether the corporation has sufficient contacts with the taxing state such that imposing the tax 'does not offend "traditional notions of fair play and substantial justice."'" (quoting *Int'l Shoe Co. v. Washington,* 326 U.S. at 316)); *Chicago Bridge & Iron Co. v. Dep't of Revenue,* 98 Wn.2d at 820 (stating that the first prong of the due process analysis in state taxation cases requires only some "minimal connection"); Det. No. 14-0342, 34 WTD 250 (2015)

With respect to the second requirement under the Due Process Clause, wide latitude is given to a state's selection of a method for attributing value of the enterprise to be taxed. *Moorman Mfg. Co.,* 437 U.S. at 274. We also note that a single-factor apportionment formula, like the one at issue here, is presumptively valid under the Due Process Clause. *Id.* at 273 (citing *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 41 S.Ct. 45, 65 L.Ed. 165 (1920)). Such a selection "will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted' or has 'led to a grossly distorted result.'" *Moorman Mfg. Co.,* 437 U.S. at 274 (citations omitted); *see also Exxon Corp. v. Dep't of Revenue,* 447 U.S. 207, 227 (1980) (holding that a state's taxing formula satisfies the second requirement of the Due Process Clause if it is not inherently arbitrary and does not tax a portion of the taxpayer's income out of all appropriate proportion to the business transacted in that state). Thus, Taxpayer has the burden of proving, by "clear and cogent" evidence, an inappropriately disproportionate or grossly distorted taxable gross income in Washington as a result of the Audit Division's apportionment method.

Taxpayer argues that because its customers are the Issuers and Acquirer, and not the cardholders themselves, the Department is precluded under the Due Process Clause from using the location of the ATM machine used by the cardholder for apportionment purposes. *See Dot Foods, Inc. v. Washington Dep't of Revenue,* 166 Wn.2d 912, 215 P.3d 185 (2009) (holding that the Department could not consider subsequent sales of a taxpayer's product to determine the taxpayer's eligibility for an exemption because Taxpayer "essentially has nothing to do with" those subsequent sales). In other words, Taxpayer argues that because it has no direct relationship with the cardholders, the

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[9] Taxpayer also cited to two state tax cases from other jurisdictions. *See In re Income Tax Protest of Scioto Ins. Co.,* 279 P.3d 782 (Okla. 2012); *Griffith v. ConAgra Brands, Inc.,* 229 W.Va. 190, 728 S.E.2d 74 (W.Va. 2012). While neither of these cases is controlling here, we note, nevertheless, that in both cases, the taxpayer did not have minimum contacts in the taxing states. Here, as we explained above, Taxpayer did have minimum contacts in Washington.

Department violates the Due Process Clause by considering the location of the ATM machines used by those cardholders when apportioning Taxpayer's gross income. We disagree.

In *Dot Foods,* once the taxpayer completed its sales of products to its customers, it no longer had any involvement with the subsequent sales or use of those products. *Id.* at 923. Here, however, after Taxpayer enters into agreements with its customers, the Issuers and the Acquirers, Taxpayer continues to remain involved in the subsequent ATM card transactions, facilitating the authorization, clearing, and settlement processes, and effecting the successful completion of the ATM card transactions, which have their beginning and end point at the ATM machine locations in Washington. Moreover, the income Taxpayer receives from its customers is directly tied to the total number of individual transactions, and the amounts of those transactions, which are both dictated by the actions of the individual cardholders. In essence, Taxpayer's customers conduct their business activities at those ATM machine locations, albeit through electronic transmission of information. We conclude that the fact that the Audit Division used the ATM machine locations in its apportionment method does not, alone, rise to the level of "clear and cogent" evidence that such apportionment method has led to inappropriately disproportionate or grossly distorted tax liability.

Because Taxpayer has not offered any other evidence in support of its argument, we conclude that Taxpayer has not met its burden, and that the second requirement of the Due Process Clause has been met here. Accordingly, we conclude, in turn, that the Department's assessment of B&O tax against Taxpayer does not violate the Due Process Clause.

3. Apportionment Method

In addition to Taxpayer's constitutional arguments, [Taxpayer] argues that "[Taxpayer's] receipts are properly sourced based upon the location of its financial institution customers." We interpret this as a challenge to the method the Audit Division used to apportion Taxpayer's gross income to Washington.

As of June 1, 2010, the method of apportioning certain gross income for businesses like Taxpayer that earn income under the service & other activities B&O tax classification under RCW 82.04.460(1) provided as follows:

> Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

Income apportioned to Washington is multiplied by a "receipts factor," the numerator of which is the gross income of the business attributed to Washington and the denominator of which is the gross income of the business worldwide. RCW 82.04.462(1), (3)(a). The statute provides a series of cascading criteria for purposes of determining to which state gross income should be attributed. As of June 1, 2010, RCW 82.04.462(3)(b) provided as follows:

> [F]or purposes of computing the receipts factor, gross income of the business Generated from each apportionable activity is attributable to the state:
>
> (i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property.
>
> (ii) If the customer received the benefit of the service or used the intangible property in more than one state, gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.
>
> (iii) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i) or (ii) of this subsection (3), gross income of the business must be attributed to the state from which the customer ordered the service or, in the case of royalties, the office of the customer from which the royalty agreement with the taxpayer was negotiated.
>
> (iv) If the taxpayer is unable to attribute gross income of the business under the provisions of (b)(i), (ii), or (iii) of this subsection (3), gross income of the business must be attributed to the state to which the billing statements or invoices are sent to the customer by the taxpayer.
>
> . . .
>
> (viii) For purposes of this subsection (3)(b), "customer" means a person or entity to whom the taxpayer makes a sale or renders services or from whom the taxpayer otherwise receives gross income of the business. "Customer" includes anyone who pays royalties or charges in the nature of royalties for the use of the taxpayer's intangible property.

Rule 19402 is the Department's administrative rule implementing RCW 82.04.462.[10] Rule 19402(301) provides the following additional information regarding the attribution of apportionable income:

> 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 . . . ;

[10] Rule 19402 was originally issued on an emergency basis on June 2, 2010, and then extended on an emergency basis in successive installments until it was permanently adopted on September 17, 2012, finally becoming effective October 18, 2012.

(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. 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.

[(Emphasis added.)]

Rule 19402(301) goes on to describe additional cascading steps in the series that a taxpayer is to follow if either (a)(i) or (a)(ii) are not feasible. These additional steps mirror the steps described in RCW 82.04.462(3)(b)(iii) – (vii), listed, in part, above. As Rule 19402(301) makes clear, most taxpayers will generally be able to attribute their apportionable gross income under Rule 19402(301)(a)(i) because the location of the "benefit of that taxpayer's service" is . . . [determinable], or through some "reasonable method" of determining such location.

Rule 19402(303)(c) defines the "benefit of the taxpayer's service" in particular situations, stating, in relevant part, "[i]f 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 of the taxpayer's service is **received where the customer's related business activities occur**." *Id.* (emphasis added). We conclude here that (1) Taxpayer's processing services for ATM card transactions do not relate to real or tangible personal property, (2) Taxpayer provides those services to customers (the Issuers and Acquirers) who are engaged in business, and (3) those services relate to those customers' business activities (completing ATM card transactions). As such, pursuant to Rule 19402(303)(c), Taxpayers' customers receive the benefit of Taxpayer's service where its customers' related business activity occurs.

To determine where Taxpayer's customers' related business activity occurs, we must first determine *what* Taxpayer's customers' "related business activity" is, and then, *where* that activity occurred. As discussed earlier, Taxpayer, Issuers, and Acquirers each play a distinct, vital role in the completion of every ATM card transaction.[11] Specifically, an Issuer's "related business activity" is the authorization of ATM card cash withdrawals and the related debiting of the

[11] Although, as noted earlier, in some cases, the Issuer and the Acquirer may be the same business entity, and, in such situations, Taxpayer's service is not required.

cardholder's checking accounts for such withdrawals, while an Acquirer's "related business activity" is completing ATM card transaction through its ATM machines.

As to *where* the completion of ATM card transactions occurs, we conclude that both the Issuers' and the Acquirers' related business activities occur at the location where the "swipe" of the ATM card occurs. That "swipe" location is the location of the ATM machine, or equivalent service, where the individual cardholder is using the Issuer's authorization of cash withdrawal, and is also the location at which the Acquirer completes the ATM card transaction on its ATM machine. We, therefore, conclude that the ATM machine location is a reasonable method for attributing Taxpayer's gross income under RCW 82.04.462(3)(b)(i) and Rule 19402(301)(a)(i).

Taxpayer, however, argues that its gross income should be attributed based on the billing addresses of its customers, the Issuer and Acquirers, presumably pursuant to RCW 82.04.462(3)(b)(iv) and its counterpart in Rule 19402(301)(c). Yet, as Rule 19402(301) makes clear, the attribution methods are arranged in a "cascading . . . series of steps," requiring a taxpayer to attribute based on the first feasible step it encounters in that series. We have already concluded that the Audit Division's attribution method of determining where the benefit of Taxpayer's service was received by its customers under RCW 82.04.462(3)(b)(i), and its counterpart in Rule 19402(301)(a)(i), was reasonable. Accordingly, Taxpayer is not entitled to "drop down" to lower steps in the series for attribution of its gross income, and, therefore, may not attribute based on its customers' billing addresses.[12]

Taxpayer next argues that the "reasonable method of proportionally attributing receipts" language under Rule 19402(301)(a)(i) should be disregarded, and without such language, Taxpayer argues its gross income should be attributed pursuant to one of the lower cascading steps. Taxpayer maintains that because RCW 82.04.462(3)(b)(i), the statutory basis for Rule 19402, did not contain any language permitting a "reasonable method" until RCW 82.04.462 was amended in 2014, the Department exceeded its statutory authority when it included the "reasonable method" language in Rule 19402(301)(a)(i) beginning on June 2, 2010.[13]

[12] We note that Rule 19402(301)(a)(i) states that "[u]nder 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)." Thus, Rule 19402(301)(a)(i) contemplates that in "certain situations" even customer billing addresses may be a reasonable method of attribution. However, the two cited examples make clear that using customer billing addresses is a reasonable method under Rule 19402(301)(a)(i) if the taxpayer's customers generally receive the benefit of the taxpayer's services at that billing address location. Here, as we have concluded above, the Issuers and Acquirers do not receive the benefit of Taxpayer's services at their respective billing address locations, but at the ATM machine location as identified in the data that the Issuers and Acquirers provide to Taxpayer. As such, Taxpayer is not entitled to use the billing addresses of the Issuers and Acquirers as a reasonable method under Rule 194(301)(a)(i).

[13] RCW 82.04.462(3)(b)(i) was amended as of June 12, 2014, adding the bold language below:

> Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property. **When a customer receives the benefit of the taxpayer's services or uses the taxpayer's intangible property 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 or intangible property used by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state**.

Laws of 2014, ch. 97, § 305 (emphasis added).

We find this argument unpersuasive. The 2014 amendment to RCW 82.04.462(3)(b)(i) was the codification of the Department's interpretation of the original version of RCW 82.04.462(3)(b)(i), in effect from June 1, 2010, which interpretation was formally announced with the Department's promulgation of Rule 19402 on the following day. The 2014 amendment was merely a technical corrections bill. *See* [2014 Final Legislative Report, 63rd Wash. Leg., at 162 (explaining purpose of the 2014 amendment as "[c]oncerning tax statute clarifications, simplifications, and technical corrections")]. Thus, the 2014 amendment to RCW 82.04.462 was effective retroactively to the original effective date of that statute, which was June 1, 2010. *See State v. Dunaway,* 109 Wn.2d 207, 216 n.6, 743 P.2d 1237 (1987) (recognizing that "subsequent enactments that only clarify an earlier statute can be applied retrospectively.").[14]

As Taxpayer has offered no other challenges to the attribution method used by the Audit Division pursuant to RCW 82.04.462(3)(b)(i), and Rule 19402(301)(a)(i), we conclude that that method was reasonable and affirm accordingly.[15]

4. Waiver of Penalties

The authority to waive or cancel penalties or interest is found in RCW 82.32.105. Specifically, RCW 82.32.105(1) provides that if the failure to pay a tax when due is the result of circumstances beyond the control of the taxpayer, the Department shall waive penalties. Rule 228 provides guidance on "circumstances beyond the control of the taxpayer" within the meaning of RCW 82.32.105. The circumstances that are generally considered beyond the control of a taxpayer are "immediate, unexpected, or in the nature of an emergency." Rule 228(9)(a)(ii). Examples include the death or serious illness of the taxpayer or members of his or her immediate family. Rule 228(9)(a)(ii)(C). Other examples include the destruction of files or records by fire or other casualty, or the unavoidable absence of the taxpayer. Rule 228(9)(a)(ii)(D), (E).

Taxpayers claim that penalties should be waived because they "made reasonable efforts to comply with the filing requirements" for reporting apportionable income to Washington. We interpret this argument as implying that Taxpayer misunderstood its tax liability in Washington. However, Rule 228 explicitly provides that "[m]isunderstanding or lack of knowledge of a tax liability" is

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[14] Additionally, we note that while we have concluded that Taxpayer must attribute its gross income pursuant to RCW 82.04.462(3)(b)(i), as interpreted in Rule 19402(301)(a)(i), even if we allowed it to attribute under RCW 82.04.462(3)(b)(ii), the same receipts would still be attributed to Washington since, in cases where a benefit is received in multiple states, RCW 82.04.462(3)(b)(ii) requires a taxpayer to attribute receipts to the state in which the benefit of the taxpayer's service was "primarily" received. As described earlier, an ATM card transaction, in practical terms, is completed at the ATM machine location. While Taxpayer's System includes a series of actions that arguably take place at different geographic locations, the primary purpose of the System is to complete ATM card transactions. Thus, the benefit of Taxpayer's System is primarily received by all interested parties where the transaction is complete, which occurs at the ATM machine location as identified in the Issuers' and Acquirers' data provided to Taxpayer. This is the same method as that which was used by the Audit Division, and which we affirmed above.

[15] On appeal, Taxpayer also argued that gross income from the "other revenue" category should not be included in Taxpayer's measure of taxable gross income because "[n]one of the categories has any direct connection to Washington, and there is no apparent reason that any amount of 'other revenue' should be sourced to Washington." To the extent that Taxpayer is arguing that such "other revenue" should be attributed to a state other than Washington or that such revenue is "throw-out income" under Rule 19402(403), Taxpayer has failed to provide adequate evidence regarding the state to which such revenue should be attributed. In the absence of such evidence, the "other revenue" is appropriately attributed to Washington.

generally not considered to be beyond the control of the taxpayer and will not qualify for a waiver or cancellation of the penalty. Rule 228(9)(a)(iii)(B). Rule 228 does not provide relief if a taxpayer has a "reasonable basis" for its filing position. The Department has consistently held that lack of knowledge of Washington's tax obligations does not constitute circumstances beyond the control of the taxpayer. *See e.g.* Det. No. 05-0174, 25 WTD 48 (2006) (holding that out-of-state business' good-faith belief that it was not required to register and pay Washington taxes is not a circumstance beyond the control of the taxpayer); Det. No. 06-0088, 26 WTD 201 (2007) (holding lack of knowledge of Washington tax obligation is not grounds for waiver). As Taxpayer has not offered any other circumstances that were beyond its control under Rule 228(9), we deny Taxpayer's request for waiver of penalties.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 19th day of January 2016.