

Washington's Amended Sourcing Rule Could Draw Litigation, Tax Pros Say

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By Paul Jones

An amended Washington rule that will source many sales of business services to the location of the customer's market could spur legal challenges, according to practitioners.

The [amendments to](#) Wash. Admin. Code section 458-20-19402 — referred to as Rule 19402 — were adopted May 15, the state Department of Revenue announced May 22. They are intended in large part to clarify sourcing of receipts linked to services and will take effect June 15, the department said in the rule's preamble.

The changes incorporate interim guidance and include additional examples based on stakeholder feedback, the DOR said, noting that since it amended the rule in 2015 the department has received requests for additional guidance on the subsection of the rule that deals with attributing receipts. "Most comments have been with regard to subsection (303)(c) of the rule, concerning services relating to a taxpayer's customer's business activities," the department said.

But the amended rule generated concerns from practitioners and business interests, who told *Tax Notes* that it will likely lead to legal challenges by taxpayers, as the previous rule did. The broad complaint by some is that the rule will often source receipts from sales of business services — services a taxpayer provides to a business customer that relate to the customer's business activities — to the location of the business customer's market by deeming the benefit of the service to be received there, rather than at the business customer's location.

Nikki Dobay with Greenberg Traurig LLP told *Tax Notes* May 23 that in amending the rule, "the department has really doubled down on this look-through approach," whereby the market of the taxpayer's customer — that is, the location of the customer's customer — is deemed the location to which the sale is sourced.

Dobay said the 2020 Washington appellate court [decision in](#) *LendingTree LLC v. Department of Revenue* should have steered the department away from that approach. The court in that case ruled that LendingTree — which received information from prospective borrowers to via its website, and analyzed and transferred it to lenders who then made offers to the borrowers — was providing a service to the lenders, who received the service at their places of business, not at the locations of their borrower customers.

The DOR [has argued](#) that *LendingTree's* facts are specific to that case and that the decision "does not suggest that Washington must always attribute receipts to a customer's business location." But Dobay said the statute in question focuses on the customer, "so the department's continued push to source receipts based on the customer's customer seems contrary to that."

Emily Shay with the Association of Washington Business said May 29 that her group and others have also complained about the rule's sourcing of certain services to the customer's market, among other criticisms. She predicted that the amended rule will lead to a legal challenge by a taxpayer, which could turn into an appellate court case like *LendingTree*.

Scott Edwards of Lane Powell PC told *Tax Notes* on May 24 that the original rule has "been controversial from its original adoption and has generated substantial litigation," in which he has been involved.

Edwards said the "top-level sourcing standard" of the statute in question attributes a taxpayer's receipts for sales of services to the location where its customers receive the benefit. He said the amended rule's subsection 303(c) "continues to provide that, for business services . . . the customer receives the benefit of the taxpayer's service 'where the customer's related business activities occur.'"

Edwards also said the previous rule didn't provide much guidance for identifying what the business customer's related activities are or where they occur, but the new version provides a framework for answering those questions. However, as with the previous version, it "strongly favors attribution of benefit to the customer's market," he said.

"While I applaud the Department for attempting to provide clear standards for identifying the customer's related business activity, the standards adopted in the revised rule are more likely to shift the areas of dispute than to resolve them," Edwards said.

Edwards highlighted one issue in subsection 303(c)(i)(D), which effectively says that if a taxpayer's services help establish or maintain the market for the customer's product, the benefit of the services is sourced to the customer's market. The subsection borrows the language of Washington's Rule 193 physical presence nexus standard, he said, noting that the DOR's policy under that rule is that "anything a business is willing to pay for" can count as a service that helps to establish or maintain a customer's market.

That could result in an overly broad rule for sourcing services to a customer's market, which could generate legal challenges, Edwards said, adding that he had warned the department of that in written comments.

He also highlighted subsection 303(c)(iii)(B), which articulates one of the scenarios in which the benefit of a service is deemed to be at a customer's business location. It says that when a customer need not be physically present and the service relates to a "specific, known business location(s)," the benefit of the service is received at that location. But the rule doesn't provide guidance for determining when a business service relates to a specific known business location, and the examples in the updated regulation don't shed sufficient light on that question, Edwards said.