



# This Week in State Tax (TWIST)

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## Washington: Department Addresses Law Firm Economic Nexus; Apportionment

In a recently released determination, a Washington State Tax Review Officer addressed the manner for attributing a law firm's receipts from providing patent acquisition services to Washington State and whether the taxpayer met the state's B&O economic nexus standard. The taxpayer at issue was an out of state law firm that specialized in procuring patents for clients, including clients headquartered in Washington State. The Department of Revenue and the taxpayer agreed that the taxpayer's gross receipts were apportionable income but disagreed as to the amount attributed to Washington. The taxpayer asserted that 1/64 (1.56 percent) of its receipts should be apportioned to Washington because the benefits of its patent procurement services were received equally in each of the 64 U.S. states, territories, and possessions where a client received patent protection. Accordingly, the taxpayer assigned 1/64 of its receipts to Washington; when assigned in this manner, the taxpayer did not meet the state's economic nexus threshold for the tax year at issue. On audit, the Department determined the taxpayer's receipts should be sourced to Washington based on the headquarters address of its customers. The matter eventually came before the Hearing Officer.

The key issue before the Hearing Officer was where the taxpayer's customers received the benefit of the taxpayer's services, which was determined to be the location where the customers' related business activity occurred. Because acquiring patents was a detailed and time-consuming process that involved broad strategic decisions from a client's management and corporate legal counsel, the Hearing Officer determined that the taxpayer's customers' relevant related business activity was strategic planning and general corporate management, rather than the customers' selling activities. While the patents allowed the holder to protect the market for its sale of a product that incorporates the patented invention, such protection required litigation to enforce the patent. Importantly, the taxpayer did not litigate to enforce patents, but only acquired patents for its customers. As such, the Hearing Officer concluded that the taxpayer's services were detached from its customer's selling activity and related more to its customers' general strategic planning and corporate management. Next the Hearing Officer addressed where these strategic and management decisions occurred, noting that the patent acquisition process was so cumbersome that it required "broad strategic decisions" from those management and legal personnel who are presumed to work from that customers' headquarters. As a result, the Hearing Officer concluded that when the customers' related business activities occurred at the customers' headquarters in Washington State those receipts would be included in the Washington sales factor numerator. Please contact Michele Baisler with questions on Det.No. 21-0044, 41 WTD 355 (2022).



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