



TaxNewsFlash

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Washington State: Penalties on unfiled annual reconciliation of “apportionable income”

The Washington Department of Revenue is imposing penalties as high as 29% on certain taxpayers that did not file an annual reconciliation of “apportionable income” form.

The Department is assessing the penalty even if the taxpayer did not report apportionable income on its original, timely filed Washington Business and Occupation tax (B&O tax) returns—e.g., the return is filed under one or more of the non-apportionable income B&O tax classifications such as retailing, wholesaling or manufacturing).

KPMG observation

To avoid the potential 29% penalty, taxpayers need to consider filing an annual reconciliation by the October 31, 2016 due date—regardless of whether apportionable income was reported on their returns.

B&O tax—overview

Washington State’s B&O tax is a gross receipts tax measured by the value of products, gross proceeds, or gross income of a business. The B&O tax employs various tax classifications—most commonly “retailing,” “wholesaling,” “manufacturing,” and “service and other” activities. The “service and other” classification captures any activity not explicitly taxed under another B&O tax classification.

Income from certain business activities, such as “service and other,” is deemed “apportionable income.” This means that the taxpayer must apply an apportionment factor to calculate the deduction for income derived outside Washington to arrive at income subject to Washington B&O tax. Most taxpayers are required to file and remit

B&O tax on a monthly basis, while other taxpayers file and remit B&O tax on a quarterly or annual basis.

Taxpayers reporting apportionable income are allowed to calculate the receipts factor for the current tax year based on the most recent calendar year for which information is available for a full calendar year. Alternatively, taxpayers may calculate the receipts factor based on current year information. In either case, RCW 82.04.462(4) requires a taxpayer to file an annual reconciliation by October 31 of the following tax year correcting the reporting for the current year.

WAC 458-20-19402 makes clear that the reconciliation must be filed, whether a refund or additional tax is due. If the annual reconciliation is not filed with additional tax paid by October 31, penalties apply on any additional tax due. Penalties are assessed at a rate of:

- 9% if the reconciliation is not filed and tax has not been paid by the due date
- 19% if the reconciliation is not filed and tax has not been paid by the end of the month following the due date
- 29% if the reconciliation has not been filed and tax has not been paid by the end of the second month following the due date

KPMG observation

KPMG tax professionals have recently become aware that the Department has taken a position that the 29% penalty for failing to file an annual reconciliation applies to any additional tax assessed on apportionable income even if the taxpayer did not report any apportionable income on its timely filed returns. There are reports that the Department is considering issuing a formal policy on this issue in the future, but in the meantime, this appears to be the Department's current practice.

It is not uncommon for taxpayers that do not otherwise report apportionable income on their returns to be assessed tax on apportionable income on audit. This can occur for a variety of reasons. For example, on audit, the Department may reclassify a taxpayer's receipts from "retailing" to "service and other" receipts, which are taxed at a higher rate than "retailing" receipts. Another common scenario is that a taxpayer may have receipts—such as intercompany receipts—that it failed to include on its timely filed returns.

As a result, there is risk that taxpayers could be assessed tax on apportionable income on audit and be subject to the 29% penalty—even if they are currently filing under non-apportionable income B&O tax classifications (e.g., retailing, wholesaling or manufacturing).

KPMG observation

What steps are available for taxpayers to consider? Those taxpayers reporting apportionable income on their returns must file an annual reconciliation, regardless of

whether the taxpayers calculated their receipts factor based on prior year or current year information and regardless of whether the reconciliation results in a change to the amount of tax due. All other B&O taxpayers that do not report apportionable income on their returns need to consider filing an annual reconciliation. Simply filing the reconciliation by the October 31 due date—even if a no-change reconciliation is filed—may serve to protect the taxpayer from the 29% penalty in the event the Department later assesses additional tax on apportionable income.

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