
Apportionment of Income by Stockbrokers and Security Houses

Introduction & Background

In the 1970s the State of New York attributed to New York 40% of an out of state security house's income from executing trades on a New York stock exchange. In *Merrill, Lynch Pierce, Fenner & Smith, Inc. v. Department of Revenue*, Docket No. 843, the Washington State Board of Tax Appeals stated: "No factual evidence was presented to indicate that any ratio other than sixty-forty was proper...." Therefore, 60% of the revenue from trades on out-of-state stock exchanges was assigned to Washington.

New York reevaluated its regulation in the 1990s and determined that the appropriate balance was only 20% to New York. Between 2000 and 2002, the Department of Revenue began informing individual taxpayers that the 60/40 convention would no longer be used to apportion income to Washington. Nonetheless, the Department also continued to acquiesce in its use for some taxpayers.

Use of 60/40 Convention Not Appropriate before June 1, 2010

Prior to June 1, 2010, RCW 82.04.460 authorized apportionment of income by either an accurate separate accounting method or cost apportionment. A taxpayer was required to apportion all of its income using either separate accounting or cost apportionment. Taxpayers were not allowed to separately account for part of their income and use cost apportionment for the remainder.

The 60/40 convention was not an accurate method of separate accounting. Further, the 60/40 convention was not based on costs; therefore, it was not a cost apportionment methodology.

Effect of Single Factor Apportionment

Effective June 1, 2010, Washington changed its apportionment methodology to a single factor receipts formula. This change means that for periods after the effective date all security houses must apportion using the new single factor receipts

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apportionment methodology. Use of cost apportionment and separate accounting methodologies are no longer authorized under Washington law.

**Refund Claims
Based on 60/40
Convention**

Requests based on the 60/40 convention by security houses for a refund of taxes paid prior to June 1, 2010, will be denied because those taxpayers did not rely on the Department's prior acquiescence to the use of the 60/40 convention. *See Stroh Brewery Co. v. Department of Rev.*, 104 Wn.App 235, 15 P.3rd 692 (2001).

**Audits of
Security
Houses for
Periods Prior
to June 1, 2010**

The Department will determine the tax liability of security houses for periods prior to June 1, 2010, by apportioning income based on an accurate separate accounting method or cost apportionment.

For periods prior to June 1, 2010, the Department will not question the use of the 60/40 convention by security houses that received specific written instructions from the Department to do so.
