

**WAC 458-20-28003 Sales and use tax avoidance arrangements described in RCW 82.32.655 (3)(c).** (1) **Preface.** This rule includes a number of examples that identify a set of facts and then state a conclusion. The examples should be used only as a general guide. The department will evaluate each case on its particular facts and circumstances and apply both this rule and other statutory and common law authority. An example that concludes an arrangement or transaction is not unfair tax avoidance under this rule does not mean that the arrangement or transaction is approved by the department under other authority.

The tax consequences of all situations must be determined after a review of all facts and circumstances. Additionally, each fact pattern in each example is self-contained (e.g., "stands on its own") unless otherwise indicated by reference to another example. Examples concluding that sales tax applies to the transaction assume that no exclusions or exemptions apply, and the sale is sourced to Washington.

(2) **Property ownership by a controlled entity as a potential tax avoidance arrangement.**

(a) **Required elements.** All three of the following elements must be met for property ownership by a controlled entity to be considered a potential tax avoidance arrangement:

(i) The taxpayer engages in a transaction in which the taxpayer, or a person(s) acting in concert with the taxpayer, vests title or any other ownership interest of tangible personal property in an entity;

(ii) The taxpayer exercises control over the entity in such a manner that the taxpayer effectively controls the tangible personal property; and

(iii) The tangible personal property is used by the taxpayer in Washington without payment of Washington retail sales tax or use tax on its full value.

The arrangement or transaction is unfair tax avoidance only if it meets all three of the elements in (a)(i) through (iii) of this subsection and is also determined to be unfair tax avoidance under WAC 458-20-280(3). If the arrangement or transaction is determined to be unfair tax avoidance, the department will determine and assess tax according to the actual substance of the arrangement or transaction which is presumed to be direct acquisition, ownership and use of the tangible personal property by the taxpayer.

(b) **Definition of "entity."** For purposes of this subsection, an "entity" is any taxable entity including, a trust, estate, corporation, limited liability company, partnership, joint venture or other business or financial structure with a legal or identifiable separate existence.

(c) **Control of the entity.** A taxpayer controls an entity when either:

(i) The taxpayer possesses, directly or indirectly, more than fifty percent of the voting power of the entity, or more than fifty percent of the power to direct or cause the direction of the management and policies of the entity, whether through ownership, power of revocation, by contract, or otherwise; or

(ii) A taxpayer exercises control over an entity in such a manner as to effectively retain control over the tangible personal property when the taxpayer has the power to direct or cause the direction of the use or disposition of the tangible personal property, including the power of direction and control held by a principal over an agent.

(d) **Attribution.** A taxpayer's total percentage of voting power or power to direct the management or policies of an entity, or of the

tangible personal property also includes the voting or management authority held by, or for the benefit of:

(i) Persons related to the taxpayer as defined in WAC 458-20-280 (1)(b)(vi); and

(ii) Persons with whom the taxpayer acts in concert to obtain control over the tangible personal property or entity in excess of the share of control attaching to a person's ownership or beneficial interests in the entity.

(e) **Presumption of control.** Whether a person has effective control over tangible personal property is based on all facts and circumstances. A person is presumed to have effective control over the tangible personal property when the person has control over the entity that holds the property.

(f) **Full value.** "Full value" means the fair market value of the tangible personal property at the time it is first used in Washington.

(g) **Safe harbor - No tax benefit.** The department will not disregard title in or ownership by a controlled entity if the arrangement does not provide an exemption, deduction, or otherwise result in a reduction in taxes, under chapter 82.08 or 82.12 RCW that would not have been available if the taxpayer had been vested with title or ownership directly. Similarly, the department will not disregard title in or ownership by a controlled entity if deferred retail sales tax or use tax is paid on the full value of the tangible personal property when it is first used in Washington.

(h) **Safe harbor - Bona fide merger or sale of a business.**

The department will not disregard title in or ownership by a controlled entity when that arrangement arises out of or is related to the sale of stock or ownership interests in a substantive operating business, including as part of a statutory merger. For purposes of this subsection, "substantive operating business" means a business that is adequately capitalized and carries on substantial business activities using its own property or employees, other than the business of owning or leasing tangible personal property of the kind or nature as the tangible personal property at issue.

(i) **Safe harbor - Certain leasing arrangements.**

The department will not disregard the title in or ownership by a controlled entity when substantially all use of the property is under a lease, at a reasonable rental value or for a timesharing fee, by a substantive operating business for bona fide business purposes, or by a person who is not related to the taxpayer, or a combination of these, provided that retail sales tax is collected and remitted on the lease payments. Similarly, the department will not disregard bailment arrangements under which substantially all use of the property is by a substantive operating business for bona fide business purposes or by a person who is not related to the taxpayer. For purposes of this safe harbor:

(i) "Substantially all use" means at least ninety-five percent of the use of the property, determined by actual use, irrespective of location.

(ii) "Reasonable rental value" means the reasonable rental value for the use of the tangible personal property, determined as nearly as possible according to the value of such use at the places of use of similar property of a like quality and character.

(iii) "Substantive operating business" means a business that is adequately capitalized and carries on substantial business activities using its own property or employees.

(iv) "Bona fide business purpose." Use of tangible personal property serves a bona fide business purpose only when the use, in nature and quantity is ordinary and necessary for the business of the user. Use for entertainment purposes must be directly related or associated with substantial business activities of the user. A bona fide business purpose may include providing employee or director benefits when the business pays the lease, the employee or director is required to report the value of the benefit as compensation for state or federal tax purposes and the benefit is ordinary and reasonable in nature or quantity for the business. See RCW 82.04.360 for the taxability of director's compensation.

(v) For aircraft only: "Timesharing fee" for purposes of this safe harbor is the total sum of all expenses of a flight authorized or permitted under 14 C.F.R. Sec. 91.501 (d) (1) through (10).

**(3) Examples.**

**Example A.** A Washington resident taxpayer forms a wholly owned Montana limited liability company (MT, LLC). MT, LLC purchases a new motor home, takes delivery and registers the motor home in Montana. MT, LLC pays no retail sales tax or use tax on the purchase. The Washington resident uses the motor home in Washington under a bailment, paying use tax on the reasonable rental value of the motor home. This is a potential tax avoidance arrangement. The taxpayer has complete control over MT, LLC and effective control over the motor home. The taxpayer uses the motor home in Washington, but Washington retail sales or use tax has not been paid on its full value. No safe harbor applies. However, the arrangement is only unfair tax avoidance if it is also determined to be tax avoidance under WAC 458-20-280(3).

**Example B.** Assume the same facts as Example A, but MT, LLC is owned by a husband and wife, with each having a fifty percent ownership interest in the company. This is still a potential tax avoidance transaction because each spouse's ownership interest in MT, LLC is attributable to the other. Both spouses are deemed to have control over MT, LLC and effective control over the motor home.

**Example C.** Three Washington residents who are unrelated to each other form a Washington limited liability company. The company purchases an aircraft in Washington for the purpose of leasing to its members and does not pay retail sales tax on the purchase. Each member of the company has a one-third ownership interest and equal voting rights, equal rights to direct the management and policies of the company, and equal power to direct the use or disposition of the aircraft. All use of the aircraft by company members is in Washington, for recreational purposes, and at a fair market rate. The company collects retail sales tax on all lease payments. This is not necessarily a potential tax avoidance arrangement because none of the members of the company is in control of the company or of the aircraft. However, if the members act in concert to control use of the aircraft in excess of their share of ownership interest, a potential tax avoidance arrangement exists unless a safe harbor applies and it is also determined to be tax avoidance under WAC 458-20-280(3).

**Example D.** Assume the same facts as Example C, but the members of the company enter into a use agreement with respect to the aircraft under which one of the members, A, is entitled to use the aircraft at any time on a priority basis, while the remaining members are entitled to use the aircraft only if A is not using it. This is a potential tax avoidance arrangement because A acts in concert with the other members regarding the direction and control of the aircraft to obtain rights of use disproportionate with A's ownership or beneficial interests in

the entity. Because A is working in concert with the other members of the company, ownership and control held by the other members are attributed to A. Therefore, A is deemed to have 100% of the control of the entity and the aircraft. However, the arrangement is only unfair tax avoidance if no safe harbor applies and it is also determined to be tax avoidance under WAC 458-20-280(3).

**Example E.** Corporation Y is a substantive operating business located in Washington. Corporation Y forms a Nevada LLC to hold an aircraft that is purchased out of state, but hangared in Washington. Individual I is the president of Corporation Y. Corporation Y leases the aircraft from the LLC. The Nevada LLC collects and remits retail sales tax on the lease payments. Corporation Y hires a third-party management company to provide a pilot and crew to fly Individual I to destinations within and without Washington for bona fide business purposes. In addition, Individual I occasionally subleases the aircraft from Corporation Y for I's personal use and Corporation Y collects a time-sharing fee from Individual I, but this totals less than 5% of the total use of the aircraft. Assume the uses by Corporation Y and Individual I are the only use of the aircraft. This is not a potential tax avoidance arrangement because it meets the requirements of the safe harbor in subsection (2)(i) of this rule.

**Example F.** Assume the same facts as Example E, but assume the aircraft was purchased and delivered out of state, and that it is hangared in Oregon. The Nevada LLC does not collect retail sales tax on the lease payments, because the leases are sourced to Oregon. This is a potential tax avoidance arrangement because tax on the lease payments is not paid to Washington.

**Example G.** A parent company forms a subsidiary, "Y," to purchase and hold a yacht for lease to the parent company for use in Washington. All leases of the yacht are as bareboat charters at a fair market lease rate. The parent company uses the yacht to provide benefits to its directors, to entertain business clients, and for company celebrations. Assume no other use of the yacht, and that the directors report the value of yacht benefit as compensation for B&O and federal income tax purposes. This arrangement meets the safe harbor under subsection (2)(i) of this rule, provided that the described uses by the parent company are quantitatively ordinary and necessary for the business of the parent.

**Example H.** Assume the same facts as in Example G, but the company only provides the yacht benefit to one of its officers/directors. Assume the benefit allows the officer/director to use the yacht on a priority basis, and that the addition of the yacht benefit makes the officer's/director's compensation materially higher than similarly situated officers/directors within the industry. In the absence of other relevant facts, this arrangement does not meet the safe harbor under subsection (2)(i) of this rule, because it is not ordinary or necessary for a business to provide a single officer with such disparate treatment. However, it is only unfair tax avoidance if the arrangement is determined to be tax avoidance under WAC 458-20-280(3).

**Example I.** Assume the same facts as in Example G, and that the parent's annual gross income is \$50,000. Assume that the total annual payments by the parent for its use of the yacht is \$25,000. This arrangement does not meet the safe harbor under subsection (2)(i) of this rule, because it is not ordinary or necessary for a business to spend the equivalent of half of its annual gross income on the use of a yacht. However, it is only unfair tax avoidance if the arrangement is determined to be tax avoidance under WAC 458-20-280(3).

**Example J.** Company S owns tangible personal property purchased in a retail sale under which all retail sales taxes were paid. Washington resident, Company B, wants to purchase that property from Company S. Company B is a substantive operating business. Company S forms an LLC and transfers the property to it in exchange for all 100% of the ownership interests. Company S then sells 100% of the ownership interests in the LLC to Company B. Company B is now the parent company of the LLC. Company B uses the property in its Washington business activities under a bailment arrangement with the LLC without paying use tax. This is a potential tax avoidance arrangement because Company B, in concert with Company S, vests title of the property in an entity over which Company B obtains control, and then uses the property in Washington without paying retail sales or use tax. It does not meet any of the safe harbors under subsection (2)(g), (h), or (i) of this rule. However, it is only tax avoidance if the arrangement is also determined to be tax avoidance under WAC 458-20-280(3).

**Example K.** Assume the same facts as Example J, but Company B obtains use of the property through a fair market rate lease arrangement with the LLC. Assume all use of the property by Company B is for bona fide business purposes. This is not a potential tax avoidance arrangement because the arrangement qualifies for the safe harbor under subsection (2)(i) of this rule.

**Example L.** Assume the same facts as Example K, except that only 90% of the use of the property is by Company B under a fair market lease arrangement for bona fide business purposes. Assume that the other 10% of the use of the property is personal use by Individual I, who is the sole owner of Company B. This is potential tax avoidance because Individual I controls the property through control of Company B and uses the property in Washington without paying retail sales or use tax on the full value of the property. The arrangement does not qualify for any of the safe harbors in subsection (2)(g), (h), or (i) of this rule. However, the arrangement is only tax avoidance if it is determined to be tax avoidance under WAC 458-20-280(3).

**Example M.** Company O, an Oregon company, is wholly owned by an Oregon resident. Company O purchases an aircraft for lease to the Oregon resident. The Oregon resident uses the aircraft in Washington for personal purposes, for periods not in excess of 59 days. The aircraft lease is for less than fair market rate. This is a potential tax avoidance arrangement, but the department will not disregard the arrangement because no use tax is due on the Oregon resident's use of the tangible personal property in Washington pursuant to RCW 82.12.0251(1). This qualifies for the safe harbor under subsection (2)(g) of this rule.

**Example N.** A Washington Taxpayer owns a painting with a significant fair market value. Taxpayer is the sole beneficiary of a trust formed under the laws of the state of Oregon with an Oregon trustee. Under the terms of the trust, the trustee must obtain Taxpayer's authorization before disposing of any trust asset. Assume the trustee of the trust purchases a sculpture from an unrelated party and accepts delivery in Oregon. Taxpayer and the trust then enter into an agreement under which Taxpayer will purchase the trust's sculpture in exchange for cash and the painting held by Taxpayer. Taxpayer pays retail sales tax or use tax on the difference in value between the trade-in painting and the acquired sculpture. Taxpayer displays the sculpture in Washington. This arrangement is a potential tax avoidance arrangement. Taxpayer is the sole beneficiary of the trust and has control over the trust property. Taxpayer uses the trust to create a

trade-in arrangement and obtain the use of property in Washington without paying sales or use tax on its full value. The arrangement does not meet any of the safe harbors under subsection (2)(g), (h) or (i) of this rule. However, it is only tax avoidance if the arrangement is also determined to be tax avoidance under WAC 458-20-280(3).

**Example O.** Company T owns tangible personal property and has paid sales or use tax on the full value of that property. Assume Company T is a substantive operating business as defined in subsection (2)(i)(iii) of this rule. Company A intends to acquire Company T through a merger transaction. Company A forms a wholly owned subsidiary, Newco and Company T is merged into Newco. The entity surviving the merger, Newco, now owns the tangible personal property formerly owned by A. After the merger is completed, Newco permits Company A to use the tangible personal property under a bailment arrangement. Company A does not pay sales or use tax on the value of the property it uses because Newco, as the successor to Company T, is a bailor that has paid sales or use tax on the property. This is not a tax avoidance arrangement because it qualifies for the safe harbor under subsection (2)(h) of this rule.

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). WSR 15-09-004, § 458-20-28003, filed 4/2/15, effective 5/3/15.]