Cite as Det. No. 90-145, 9 WTD 286-7 (1990)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 93-269ER, 14 WTD 153 (1995).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition	)	D E T E R M I N A T I O N
For a Ruling in the Matter of	)	
	)	No. 90-145
	)	
. . .	)	Registration No. . . .
	)	Request for Ruling
	)	

[1] **RULE 109:** B & O TAX - DEDUCTION - LOANS - INTEREST -THIRD PARTY LOANS - COMPANY ACTING AS CONDUIT. When a taxpayer acts as a conduit in procuring a loan from a third party lending source for the benefit of a related company on a straight pass-through (conduit) basis, tax is not due on interest income paid to the taxpayer when interest received from the related company is in turn repaid to the taxpayer's third party lender. Howard S. Wright cited.

[2] **RULE 109:** B&O TAX - DEDUCTION - INTEREST - MONEY MANAGEMENT - BRIGHT LINE TEST - OBJECTIVE STANDARDS. The bright line test criteria to determine if a claimed money management system through which a parent company funds the operation of its subsidiary companies constitutes the mere "use of money as such" entitled to B&O tax deduction under RCW 82.04.4281 are fourfold:

1) Company funds are moved back and forth between entities or accounts within the internal business structure on a daily basis;

2) The subsidiary or affiliated entities whose daily operations are funded in this manner are majority owned and controlled by the same parent or its owners;

3) There are no written evidences of indebtedness memorializing the funding activity and creating any creditor-debtor relationship between the parties, on either a demand or term payment basis;

4) The functions performed to accomplish the money movement between entities or accounts are the same as those performed by banks and other financial institutions, utilizing a daily targeted minimum or zero account balance method.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: January 4, 1990

NATURE OF ACTION:

Petition for ruling concerning the tax implications of certain borrowing and lending activities within a group of affiliated companies.

FACTS:

Bauer, A.L.J.-- The taxpayer is a construction company in the State of Washington, and a member of "Group X." Group X has a U.S. parent holding company ("P," incorporated in Delaware), which in turn is 100% owned by a foreign (outside of U.S.) corporation. P is registered in Washington State, and will maintain a bank account either in Washington or another state. It currently has no employees here or elsewhere.

P owns other U.S. corporations, one of which is the taxpayer, and these other corporations in turn have other wholly-owned subsidiaries. These corporations have many businesses, some of which are financial.

In the transaction at issue, P will borrow funds from either an unrelated third party or from another member within its worldwide group who will borrow from an outside lender. P will loan monies down through its affiliates, eventually reaching the taxpayer. The taxpayer will in turn loan substantially all the money back through the affiliates to P. A minor amount may be used to extinguish other external debt.

P will repay its loan to the lender after the restructuring. All transactions will take place over only a few days with the net effect of placing an intercompany note receivable and a note payable of identical amounts on each of the affiliate's books.

This is a single transaction separate from the cash management system of Group X. The amount of interest income will be significant. The taxpayer argues that since the funds for each transaction will have been received from a third party, neither P nor the taxpayer will be in competition with banks or other financial institutions.

Each step will result in approximately identical interest expense and income, all passing back and forth within the framework of Group X. This will not be a regular or recurring transaction.

A separate cash management system adhering to the "bright line test" outlined in Determination 88-246 and Determination 88-266 will also be incorporated by Group X. It will be distinct and separate from the incidental loan discussed above.

TAXPAYER'S ARGUMENT:

The taxpayer argues that the above-described loan transaction is merely a circular transfer of funds inside the group. The ultimate goal of the transaction is to facilitate a book entry to increase the asset position of the taxpayer - and other participating entities -for regulatory purposes. A corresponding liability will be established on the taxpayer's balance sheet. There will be no increase in the net worth of the taxpayer as a consequence of this intercompany loan receivable/payable. There will be documentation detailing the loans and signed notes outlining the payment structure. All interest rates on the loans receivable and payable are identical, at prime, and reviewable annually.

The taxpayer thus concludes that this particular loan activity will be accomplished for the sole purpose of increasing its asset position - by bolstering its assets with a loan receivable. Apparently there are entities which evaluate a business only on the amount of its assets (i.e., loan receivables), without taking into account its liabilities (i.e., loan payables). The taxpayer's position is basically that there is no income or profit motive to this transaction - and thus no "business activity."

The taxpayer cites as authority RCW 82.04.4281, which allows a deduction from the measure of the B&O tax for amounts received by persons, except those engaged in banking, loan, security or other financial businesses, from investments or the use of money as such, and related ETBs, court decisions, and various determinations published by the Department.

The taxpayer contends that the proposed fact pattern follows RCW 82.04.4281, and is directly on point with Howard S. Wright Construction Co. et Al v. Department of Revenue, Thurston County Superior Court Docket No. 79-2-01310-0 (1981), in which the Court ruled that loans to affiliated companies by the parent were "investments that were merely 'incidental' and not taxable.

The taxpayer also argues that its position is in line with Determination 86-237, 1 WTD 115 (1986), which cited both Howard S. Wright and John H. Sellen Construction Co. v. Department of Revenue, 87 Wn.2d 878 (1976).

The taxpayer sums up its position by reiterating that the primary goal of the loan transaction will be to provide the taxpayer with additional book assets - in this case, an intercompany note receivable. This will be offset by an intercompany note payable for essentially the same amount. The taxpayer concludes that the resulting interest income (offset by a corresponding interest expense) directly related to the above transaction will be exempt from the B&O tax since it will be an incidental activity.

The taxpayer secondly requests that the Department affirm that its cash management system, which will use the guidelines set forth in Determination 88-266, 6 WTD 175 (1988), will be exempt.

ISSUES:

The two issues on which the taxpayer requests a ruling are as follows:

1. Whether intercompany loans accomplished for the sole purpose of increasing a taxpayer's asset position for regulatory purposes, in which its loan receivables are equal to its loan payables, are exempt for B&O tax purposes.

2. Whether a cash management system which adheres to the four conditions set forth in 6 WTD 175 is exempt from B&O tax.

RULING:

The Superior court ruling in Howard S. Wright Construction, supra, is squarely on point with this case. That decision resulted from cross motions for summary judgment based upon a mutually agreed stipulation of facts.

The Court in that case adjudged that there was no genuine issue of material fact between the parties. Stipulation of fact No. 7 clearly stated that, (t)he primary source of funds loaned to affiliates is borrowing by Wright and Schuchart from banks." Third party bank loans at the same rate of interest charged to the affiliate by Wright/Schuchart was the first and foremost source of the loan funds.

The Department, in construing the Wright case, looks to the fact that such a taxpayer merely acts as a conduit in the loan transaction, in that the interest paid to it equals the interest it owes the third party from which it obtained the funds. In such cases in which the Department has held interest exempt, there has been no object of financial gain or benefit to the taxpayer making the loan.
[1] Thus, when a taxpayer acts as a conduit in procuring a loan from a third-party lending source for the benefit of a related company on a straight pass-through (conduit) basis, tax is not due on interest income paid to the taxpayer by the related company when that interest is in turn repaid to the taxpayer's third party lender.

In this case, the taxpayer engaging in the conduit loan activity will do so for the sole stated purpose of inflating its asset position. It will not enter into the transaction in order to earn interest on the loan, and will in fact gain no financial benefit from the interest it will receive since that interest will equal the interest it owes on the third party loan.

[2] As to the second issue involving a money management system, the Department confirms that the four criteria listed in 6 WTD 89 (. . .) will control, namely:

1) Company funds are moved back and forth between entities or accounts within the internal business structure on a daily basis;

2) The subsidiary or affiliated entities whose daily operations are funded in this manner are majority owned and controlled by the same parent or its owners;

3) There are no written evidences of indebtedness (such as grid notes) memorializing the funding activity and creating any creditor-debtor relationship between the parties, on either a demand or term payment basis;

4) The functions performed to accomplish the money movement between entities or accounts are the same as those performed by banks and other financial institutions, utilizing a daily targeted minimum or zero account balance method.

DATED this 28th day of March, 1990.