



RULE-MAKING ORDER

CR-103P (May 2009)
(Implements RCW 34.05.360)

Agency: Department of Revenue

Permanent Rule Only

Effective date of rule:

Permanent Rules

31 days after filing.

Other (specify) **(If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)**

Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?

Yes No If Yes, explain:

Purpose:

These four new rules assist in determining whether a transaction or arrangement is designed to unfairly avoid taxes within the scope chapter 82.32.655 RCW. WAC 458-20-280, WAC 458-20-28001, WAC 458-20-28002, and WAC 458-20-28003 is a set of four rules: one general rule and three separate rules for each of the three types of tax avoidance identified in RCW 82.32.655(3). The rules are necessary to explain the implications of the legislation in 82.32.655 RCW.

Citation of existing rules affected by this order:

Repealed:
Amended:
Suspended:

Statutory authority for adoption: RCW 82.32.300 and RCW 82.01.060(2)

Other authority :

PERMANENT RULE (Including Expedited Rule Making)

Adopted under notice filed as WSR 14-21-156 on October 21, 2014.

Describe any changes other than editing from proposed to adopted version:

The following are the changes to the proposal for WAC 458-20-280 to WAC 458-20-28003 for the tax avoidance rules. WAC 458-20-28003(3)(E) has been revised to reflect changes in an aircraft lease arrangement that more accurately reflects personal use sublease transactions with timesharing fees in Washington. In addition, the definition of timesharing fee in WAC 458-20 -28003(2)(i)(v) has been changed to reflect a citation to the definition in the federal aviation regulations.

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting: **An analysis was not prepared.**

Name: phone ()
Address: fax ()
e-mail

Date adopted: April 2, 2015

NAME

Dylan Waits

SIGNATURE

TITLE

Rules Coordinator

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: April 02, 2015

TIME: 9:44 AM

WSR 15-09-004

**Note: If any category is left blank, it will be calculated as zero.
No descriptive text.**

**Count by whole WAC sections only, from the WAC number through the history note.
A section may be counted in more than one category.**

The number of sections adopted in order to comply with:

Federal statute:	New	Amended	Repealed
Federal rules or standards:	New	Amended	Repealed
Recently enacted state statutes:	New	Amended	Repealed

The number of sections adopted at the request of a nongovernmental entity:

New	Amended	Repealed
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The number of sections adopted in the agency's own initiative:

New	Amended	4	Repealed
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The number of sections adopted in order to clarify, streamline, or reform agency procedures:

New	Amended	Repealed
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The number of sections adopted using:

Negotiated rule making:	New	Amended	Repealed
Pilot rule making:	New	Amended	Repealed
Other alternative rule making:	New	Amended	Repealed

GENERAL RULE: TAX AVOIDANCE

NEW SECTION

WAC 458-20-280 Introduction. *This rule is organized into eight parts, as follows:*

- *Purpose and general scope*
- *Transactions or arrangements specifically identified as potential tax avoidance*
- *Relevant factors in transactions deemed unfair tax avoidance*
- *Economic positions of participants*
- *Substantial nontax reasons for entering into an arrangement*
- *Results of unfair tax avoidance transactions*
- *Tax periods affected*
- *Penalty provisions*

Other rules. There are three auxiliary rules that address the following three types of arrangements.

- *WAC 458-20-28001 Construction joint ventures and similar arrangements described in RCW 82.32.655 (3)(a);*
- *WAC 458-20-28002 Disguised income arrangements described in RCW 82.32.655 (3)(b); and*
- *WAC 458-20-28003 Sales and use tax avoidance arrangements described in RCW 82.32.655 (3)(c).*

(1) **Purpose and general scope.** Chapter 23, Laws of 2010 1st sp. sess., enacted as RCW 82.32.655 and 82.32.660, as well as amended RCW 82.32.090, to address unfair tax avoidance. Although taxpayers have the right to enter into arrangements or transactions that have lower tax consequences, the legislature recognized that certain arrangements and transactions are contrary to the intent of the taxation statutes. The legislation and this rule address certain identified arrangements and transactions that unfairly avoid taxes and prescribe specific remedial actions to be taken by the department in such cases. The legislation and this rule do not affect or apply to any other remedies available to the department by statute or common law, as these remedies are expressly preserved by the legislation.

(a) **Rule examples.** 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 taxpayer is entitled to any particular tax treatment or that the arrangement or transaction is approved by the department under other authority. It may still be disregarded or disapproved by the department under other statutory or common law authority.

In addition, each fact pattern in each example is self-contained (i.e., "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.

(b) **Definitions.**

(i) "Potential tax avoidance" and "identified transaction" both refer to an arrangement or transaction that has the potential to be unfair tax avoidance because it meets the elements of an arrangement or transaction described in subsection (2) of this rule.

(ii) "Unfair tax avoidance" means an arrangement or transaction that meets the elements of an arrangement or transaction described in subsection (2) of this rule, and that is also determined under all the facts and circumstances to be unfair tax avoidance based on the factors identified in subsection (3) of this rule.

(iii) "Affiliated" means under common control.

(iv) "Common control" means two or more entities controlled by the same person or entity.

(v) "Control" means the possession, directly or indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of an entity, whether through the ownership of voting shares, by contract, or otherwise. A person's power to cause the direction of management and policies includes power that is held by:

(A) Persons related to the taxpayer; and

(B) Persons with whom the taxpayer acts in concert to direct the management or policies of the entity.

(vi) "Related" includes:

(A) An entity's parent, owner, subsidiary, or affiliate under common control;

(B) An individual person's spouse, grandparent, parent, sibling, child, or grandchild; and

(C) In the case of a trust, the trust or a related person as defined in (A) or (B) of this subsection that:

(I) Has a beneficial interest in the trust;

(II) Has control over the trust or trust property; or

(III) Is the settlor and has retained significant control over the trust.

(vii) "Moving" or "moves" is any act or series of acts to ensure that income is received by a person who is not taxable in Washington on that income; and that the taxpayer or a related person receives substantially all the benefit of the income. Such acts may include without limitation: An assignment, transfer, lease, or license of income-producing assets; the sale of property or services at less than could be obtained in an arm's length transaction; and capital contributions and distributions from a capital account.

(viii) "Specific written instructions" means tax reporting instructions that specifically address an arrangement or transaction and specifically identify the taxpayer to whom the instructions apply. Specific written instructions may be provided as part of an audit, tax assessment, determination, closing agreement, or in response to a binding ruling request.

Specific written instructions will not be construed as revoked by operation of this rule or its statutory authority, but the department may revoke specific written instructions by written notice to the taxpayer.

(ix) "Person" or "company" has the same meaning as provided in RCW 82.04.030.

(2) **Transactions or arrangements specifically identified as potential tax avoidance:** Under RCW 82.32.655(3), the following arrange-

ments or transactions are specifically identified as potential tax avoidance.

(a) **Certain construction ventures.** Arrangements that are, in form, a joint venture or similar arrangement between a construction contractor and the owner or developer of a construction project but that are, in substance, substantially guaranteed payments for the purchase of construction services and that are characterized by a failure of the parties' agreement to provide for the contractor to share substantial profits and bear significant risk of loss in the venture. See WAC 458-20-28001 for more information.

(b) **Redirecting income.** Arrangements through which a taxpayer attempts to avoid business and occupation tax by disguising income received, or otherwise avoiding tax on income from a person that is not affiliated with the taxpayer from business activities that would be taxable in Washington by moving that income to another entity that would not be taxable in Washington. See WAC 458-20-28002 for more information.

(c) **Property ownership by controlled entity.** Arrangements through which a taxpayer attempts to avoid retail sales or use tax by engaging in a transaction to disguise its purchase or use of tangible personal property by vesting legal title or other ownership interest in another entity over which the taxpayer exercises control in such a manner as to effectively retain control of the tangible personal property. See WAC 458-20-28003 for more information.

(3) **Factors in a specifically identified arrangement or transaction deemed unfair tax avoidance:** An arrangement or transaction identified in subsection (2) of this rule, is not "unfair tax avoidance" unless the arrangement or transaction is determined to be unfair tax avoidance under consideration of one or more of the factors in this subsection. These factors do not constitute a list of discrete elements that must be met for an arrangement or transaction to be unfair tax avoidance.

(a) Whether there has been a meaningful change in the economic positions of the participants in an arrangement or transaction, apart from its tax effects, when the arrangement is considered in its entirety;

(b) Whether substantial nontax reasons exist for entering into an arrangement or transaction;

(c) Whether an arrangement or transaction is a reasonable means of accomplishing a substantial nontax purpose;

(d) An entity's relative contributions to the work that generates income;

(e) The location where work is performed¹; and

¹ For apportionable activities, see WAC 458-20-19401 through 458-20-19404.

(f) Other relevant factors.

(g) Application of factors:

(i) To the extent relevant, the department may consider any or all factors listed in this subsection as part of an analysis of whether an arrangement or transaction has sufficient substance to be respected for tax purposes. The department may consider evidence of a taxpayer's actual subjective intent, but the department is not required to prove that tax avoidance was the subjective intent of any particular arrangement or transaction.

(ii) Right of rebuttal. If the department determines that the arrangement or transaction meets the elements identified in WAC 458-20-28001, 458-20-28002, or 458-20-28003 and that one or more of

the factors identified in this subsection indicate unfair tax avoidance, the department presumes the arrangement or transaction is unfair tax avoidance. The taxpayer may rebut the presumption by proving that:

(A) The arrangement or transaction changes in a meaningful way, apart from its tax effects, the economic positions of the participants in the arrangement when considered as a whole; and

(B) One or more substantial nontax reasons were the taxpayer's primary reason for entering into the arrangement or transaction.

(4) When does an arrangement or transaction change in a meaningful way, apart from its tax effects, the economic positions of the participants in the arrangement when considered as a whole?

(a) **Whole transaction.** In evaluating any change to the economic positions of the participants, the department considers all facts and circumstances relevant to the individual economic position of each participant in the arrangement or transaction as a whole.

(b) **Meaningful change defined.** Meaningful change in economic position means, apart from its tax benefits, a bona fide and substantial increase in profit or profit potential or a bona fide and substantial reduction in costs or expenses between the form of the arrangement or transaction chosen by the taxpayer and the actual substance of the arrangement or transaction. The reasonably expected profit from the arrangement or transaction must be substantial when compared to the reasonably expected tax benefits that would be allowed if the arrangement or transaction is to be respected.

(c) **Shifting profits insufficient.** An arrangement or transaction that merely shifts income or value between related persons does not result in a meaningful change in economic position.

(5) When do substantial nontax reasons or purposes exist for entering into an arrangement or transaction?

(a) **Subjective purpose.** In evaluating whether a taxpayer had a substantial nontax reason or purpose for an arrangement or transaction, the department will consider all facts and circumstances that are relevant to determining the taxpayer's subjective intent. However, the department is not required to prove that tax avoidance was the subjective intent of any particular arrangement or transaction, but may presume such intent from the presence of other relevant factors.

(b) **Substantial nontax reason defined.** A substantial nontax reason is a bona fide nontax reason that is a substantial motivating factor to the taxpayer's decision to enter into the arrangement or transaction in this state. A bona fide nontax reason may include the purpose of obtaining tax benefits from another government, provided the benefits are not the same type, kind, or nature of any substantial Washington state tax benefit obtained under the arrangement or transaction.

(c) **Partial safe harbor.** For purposes of applying this rule, the department will treat a stated nontax purpose as a bona fide reason where all participants in an arrangement or transaction are substantive operating businesses, adequately capitalized, and carrying on substantial business activities using their own property or employees. For purposes of applying common law or statutory remedies other than under RCW 82.32.655, the department may treat stated nontax reasons as other than bona fide, if appropriate under all facts and circumstances.

(6) Results of an unfair tax avoidance transaction:

(a) **Determination of proper amount of tax.** For tax benefits received on or after January 1, 2006, the department must disregard the form of an unfair tax avoidance arrangement or transaction and deter-

mine the amount of tax based on the actual substance of the arrangement or transaction, except as provided in subsection (7) of this rule.

(b) **Amount of tax benefit defined.** The tax benefit of an unfair tax avoidance arrangement or transaction is the difference between the amount of tax due based on the actual substance of the arrangement or transaction and the amount of tax actually paid by the taxpayer based on the form of the arrangement or transaction. In determining the amount of the tax benefit, the department will credit the tax previously paid by the taxpayer against total tax assessed on the revised transaction in accordance with customary department practice.

(c) **Actual substance.** The actual substance of an unfair tax avoidance arrangement or transaction is:

(i) For transactions or arrangements described in subsection (2)(a) of this rule and WAC 458-20-28001, a sale of construction services from the construction contractor to the developer or owner.

(ii) For transactions or arrangements described in subsection (2)(b) of this rule and WAC 458-20-28002, a sale of property or services by a person subject to Washington taxes on the arrangement or transaction.

(iii) For transactions or arrangements described in subsection (2)(c) of this rule and WAC 458-20-28003, direct ownership of the tangible personal property by the user.

(7) **Tax periods affected:** The legislation addressed in this rule applies to tax benefits received on or after January 1, 2006. The legislation also contains exceptions to an application based on when an arrangement or transaction is initiated. The relationship between when the tax benefit is received and when the arrangement or transaction is initiated is explained as follows:

(a) **When is an arrangement or transaction initiated?** An arrangement or transaction is initiated when the first tax benefits are received.

(b) **When are tax benefits received?** For purposes of this rule, the timing of receipt of tax benefits is not dependent on the date on which the tax return is required to be filed, but instead:

(i) Business and occupation tax benefits are received on the date that, in the absence of tax avoidance, the taxpayer would have been subject to B&O tax under RCW 82.04.220.

(ii) Retail sales tax benefits are received on the date of the retail sale; and

(iii) Use tax benefits are received on the date of first use in Washington.

(c) **Tax benefits received January 1, 2006, through April 30, 2010.** The department will not deny tax benefits received by a taxpayer during this period if any of the following are true:

(i) The taxpayer reported its tax liability in conformance with unrevoked specific written instructions issued to that taxpayer or a person affiliated with the taxpayer as defined under subsection (1)(b)(iii), and the taxpayer's arrangement or transaction does not differ materially from that addressed in the specific written instructions.

(ii) The taxpayer reported its tax liability in conformance with a determination or other document made available by the department to the general public that specifically identifies and clearly approves the arrangement or transaction, and the taxpayer's arrangement or transaction does not differ materially from that addressed in the determination or document.

(iii) The department has completed a field audit of the taxpayer and the arrangement or transaction is covered by the audit. An arrangement or transaction is covered by an audit if the audit covered the same tax type (e.g., sales, use, business and occupation) as the tax benefit obtained by the taxpayer from the arrangement or transaction. An audit is complete when closed by the department.

(d) **Arrangement or transaction initiated before May 1, 2010, and tax benefits received after April 30, 2010.** The department will not deny tax benefits received by the taxpayer on or after May 1, 2010, if either of the following is true:

(i) The taxpayer has reported its tax liability in conformance with unrevoked specific written instructions issued to that taxpayer or a person affiliated with the taxpayer as defined under subsection (1)(b)(iii) of this rule, and the taxpayer's arrangement or transaction does not differ materially from that addressed in the specific written instructions.

(ii) The taxpayer has reported its tax liability in conformance with a determination or other document made available by the department to the general public that specifically identifies and clearly approves the arrangement or transaction, and the taxpayer's arrangement or transaction does not differ materially from that addressed in the determination or document.

(e) **Arrangement or transaction initiated on or after May 1, 2010.** For arrangements and transactions initiated on or after May 1, 2010, the department will not deny tax benefits received by the taxpayer if the taxpayer reports its tax liability in conformance with unrevoked specific written instructions issued to that taxpayer, and the taxpayer's arrangement or transaction does not materially differ from that addressed in the specific written instructions. Specific written instructions for this purpose do not include instructions provided to any other person. Further, taxpayers may not rely on any determination or other document made available by the department to the general public prior to May 1, 2010, to the extent inconsistent with this rule.

(f) **When do transactions or arrangements materially differ from those addressed in written guidance?** An arrangement or transaction materially differs from that addressed in written guidance when there is a material change in the form or substance of the arrangement or transaction, including without limitation, when there is a change of any participant identified in specific written instructions.

Example 1. A taxpayer identifying itself obtains a letter ruling from the department that specifically identifies an arrangement that constitutes unfair tax avoidance under this rule. In its letter ruling, the department approves the arrangement as presented and does not rule that the arrangement must be disregarded or the tax benefits denied. The taxpayer's arrangement does not materially differ at any point in time from the arrangement addressed in the letter ruling, and the taxpayer reports its tax liability in accordance with the letter ruling. The department will not disregard the arrangement or deny the resulting tax benefits for that taxpayer for any tax period, unless and until the letter ruling is expressly revoked.

Example 2. Assume the same facts as Example 1, but the letter ruling was sought by and issued to a person affiliated with the taxpayer as defined under subsection (1)(b)(iii) of this rule. If the arrangement was initiated and started to generate tax benefits prior to May 1, 2010, the department will not disregard the arrangement or deny the resulting tax benefits for that taxpayer for any tax period, unless and until the letter ruling is expressly revoked.

Example 3. Assume the same facts as Example 1, but the letter ruling was not sought by or issued to either the taxpayer or an affiliate. Assume that the arrangement or transaction is not addressed in any published guidance made available to the public by the department. The department must disregard the arrangement and deny the tax benefits received on or after January 1, 2006.

Example 4. The department conducts a field audit of a taxpayer for the period January 1, 2004, through December 31, 2008. The taxpayer has engaged in an arrangement that constitutes unfair tax avoidance under this rule. The arrangement was initiated January 1, 2004. The audit is completed prior to May 1, 2010. In specific written instructions, the audit expressly approves the arrangement. The taxpayer's arrangement does not materially differ at any point in time from the arrangement addressed in the audit instructions, and the taxpayer reports its tax liability in accordance with the those instructions. The department will not disregard the form of the arrangement or deny the tax benefits received for any tax period, unless and until the audit instructions are expressly revoked.

Example 5. Assume the same facts as Example 4, but the audit does not expressly approve the arrangement. Although the audit covers the same tax type as the benefits received under the arrangement, the arrangement is not specifically addressed in the audit's written reporting instructions. The taxpayer's arrangement does not differ at any point in time from the arrangement engaged in during the audit. Also assume that the arrangement or transaction is not addressed in any other published guidance made available by the department to the public.

- The department will not disregard the form of the arrangement or deny the tax benefits received through December 31, 2008, because the period is included in a completed field audit and is wholly included in the period prior to May 1, 2010.

- The department must disregard the form of the arrangement and deny tax benefits received after December 31, 2008, and prior to May 1, 2010, because the period is not included in a completed field audit.

(8) **Unfair tax avoidance penalty.**

(a) **Penalty imposed.** Except as otherwise stated in this rule, the department must assess a penalty of thirty-five percent on the amount of the tax benefit denied because of the disregard of an unfair tax avoidance arrangement or transaction.

(i) **When the unfair tax avoidance penalty applies.** The thirty-five percent assessment penalty applies to the tax benefits from engaging in unfair tax avoidance and received on or after May 1, 2010, and denied under this rule.

(ii) **Penalty safe harbor.** The department will not apply the tax avoidance penalty if the taxpayer discloses its participation in the tax avoidance arrangement or transaction to the department before the department provides notice of an investigation or audit of any kind or otherwise discovers the taxpayer's participation.

(iii) **Disclosure requirements.** The disclosure must be in writing, it must identify the taxpayer, and it must either request a ruling on the specific arrangement or transaction, or it must provide sufficient information to allow the department to reasonably determine whether the arrangement or transaction is unfair tax avoidance. Disclosure under this subsection applies only to the specific arrangement or transaction addressed in the disclosure. The disclosure no longer qualifies

for the safe harbor upon any material change to the arrangement or transaction, including a change in participants.

(b) **Discovery.** The department discovers a taxpayer's participation in an unfair tax avoidance arrangement when the department obtains any evidence of the participation from any source.

(c) **Notice.** The department provides notice of an investigation or audit when it provides either oral or written notice to the taxpayer of the investigation or audit, regardless of whether the audit covers the same tax type (e.g., retail sales, use, business and occupation) as the tax benefit obtained from the unfair tax avoidance arrangement or transaction.

(d) **Audits.** Taxpayers subject to an investigation or audit that was open as of May 1, 2010, shall be deemed to have provided disclosure to the department that satisfies the requirements of (a)(ii) of this subsection with respect to any arrangement or transaction initiated prior to May 1, 2010, that results in a tax benefit of the same type (e.g., retail sales, use, business and occupation) as covered in the open investigation or audit. If the department fails to discover the taxpayer's participation in a tax avoidance arrangement or transaction during an investigation or audit closed after May 1, 2010, the taxpayer may still apply for the safe harbor for future periods by disclosure in accordance with the requirements of (a)(ii) of this subsection.

Example 6. On or after May 1, 2010, a taxpayer identifying itself requests a letter ruling on its participation in an arrangement that constitutes unfair tax avoidance under this rule. The taxpayer specifically requests that the department determine whether the arrangement is an identified transaction or unfair tax avoidance and provides all information requested by the department. As of the date the letter ruling request is received by the department, the department had not discovered the taxpayer's participation in the arrangement and had not notified the taxpayer of its intention to investigate or audit. If the department subsequently disregards the arrangement and denies the tax benefits, the department will not apply the thirty-five percent avoidance penalty to any denied tax benefit.

Example 7. Assume the same facts as in Example 6, but the taxpayer does not specifically request that the department determine whether the arrangement is an identified transaction or unfair tax avoidance. However, in the ruling request, the taxpayer provides sufficient information for the department to reasonably determine whether the arrangement is an identified transaction or unfair tax avoidance. If the department subsequently disregards the arrangement and denies the tax benefits, the department will not apply the thirty-five percent avoidance penalty to any denied tax benefit.

Example 8. Assume the same facts as Example 7, but the taxpayer only requests a ruling on specific elements related to the tax avoidance arrangement, not the arrangement as a whole. The ruling request therefore does not contain information sufficient for the department to reasonably determine whether the arrangement is an identified transaction or unfair tax avoidance. If the department subsequently disregards the arrangement and denies the tax benefits, the department must apply the thirty-five percent avoidance penalty to any denied tax benefit.

Example 9. A taxpayer engages in an arrangement or transaction from January 1, 2005, through December 31, 2010. Assume the arrangement constitutes an unfair tax avoidance arrangement under this rule. The taxpayer does not disclose the arrangement to the department in

conformance with (a)(ii) of this subsection. If the department subsequently disregards the arrangement and denies the tax benefits, it must do so back to January 1, 2006, subject to the statute of limitations. The department must also apply the thirty-five percent avoidance penalty, but only to the portion of the assessment that results from tax benefits received on or after May 1, 2010, and denied under this rule.

Example 10. A construction contractor forms a joint venture with a developer. The venture was initiated, wound up its business, and was dissolved on April 1, 2010. Assume the joint venture constituted an unfair tax avoidance arrangement under this rule. Also assume that the venture has never been audited and did not report its tax liability in conformance with specific written instructions, or any other written authority that specifically identifies and clearly approves the arrangement. If the department subsequently disregards the arrangement and denies the tax benefits, it must do so back to January 1, 2006. The department will not assess the thirty-five percent avoidance penalty, however, because no tax benefits were received on or after May 1, 2010.

Example 11. Assume the same facts as Example 5, for tax benefits received on or after May 1, 2010, the department must disregard the form of the arrangement and deny the tax benefits received. In addition, the department must assess the thirty-five percent tax avoidance penalty unless the taxpayer discloses its participation in the arrangement in accordance with this rule.

For further information refer to WAC 458-20-28001, 458-20-28002, and 458-20-28003.

NEW SECTION

WAC 458-20-28001 Construction joint ventures and similar arrangements described in RCW 82.32.655 (3)(a). (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) **Required elements.**

(a) A construction joint venture or similar arrangement is a potential tax avoidance arrangement or transaction when it:

(i) Provides substantially guaranteed payments to the construction contractor for construction services rendered;

(ii) Does not provide the construction contractor with the right to share substantial profits in the venture; and

(iii) Does not require the construction contractor to bear significant risks of loss in the venture.

The construction joint venture is considered a sale of construction services and potential tax avoidance if (a)(i) through (iii) of this subsection elements exist and the arrangement is also determined to be unfair tax avoidance under WAC 458-20-280(3). If none of these elements exist, then it is not potential tax avoidance and cannot be unfair tax avoidance.

(b) **Form of the arrangement.** A joint venture or similar arrangement includes a joint venture, partnership, limited liability company, or any similar arrangement between a construction contractor and an owner or developer. This rule applies even if the arrangement includes additional participants. The term "construction contractor" includes any person providing construction services or services in respect to construction. The term "owner or developer" includes, without limitation, a landowner, a lessee of land, a project manager, or a construction manager. An arrangement that fails to meet all elements of a joint venture at common law may still be an arrangement that is considered a joint venture or similar arrangement under this subsection.

(c) **Substantially guaranteed payments.** A "substantially guaranteed payment" is a payment that is guaranteed, secured, or otherwise protected so as to be substantially guaranteed to occur. The determination is based on all relevant facts and circumstances including, without limitation, the terms of any operating agreement or other applicable instrument, common trade practice, and the course of dealing of the parties. The fact that a payment reduces the value of the payee's capital account is not determinative. Whether or not a payment is a guaranteed payment for purposes of Sec. 707(c) of the I.R.C. is not relevant.

(d) **Substantial profits.** A construction contractor is entitled to substantial profits only when it has a vested and unconditional right

to receive income earned by the venture in the ordinary course of the venture's business to which the construction contractor's contributed property and/or services relate, after costs of the venture are paid in full or otherwise provided. If the receipt of income is guaranteed, secured, or otherwise protected so as to be substantially guaranteed to occur, it is a substantially guaranteed payment, not a right to share in substantial profits. For purposes of determining substantial profits, a right is unconditional even though dependent on venture profitability. To be "substantial," the right to profits must be substantial when compared to the right to guaranteed payments under the arrangement.

(e) **Significant risks.** A construction contractor bears significant risks when its right to substantial profits is not guaranteed, secured, or otherwise protected so as to be substantially guaranteed to occur. A significant risk of loss to the contractor is deemed to occur when at least one-half of the fair market value of contributed services is at risk.

(3) **Examples.**

Example 1. A construction contractor and a developer create a joint venture under which the developer contributes land, and the construction contractor contributes labor and materials. All contributions and distributions are reflected in adjustments to the value of the parties' capital accounts. The construction contractor's capital account contributions are valued at out-of-pocket cost of labor and materials plus 12% designated as overhead. The venture agreement provides that the venture will obtain a bank construction loan and will use the construction draws to periodically pay down the construction contractor's capital account. The terms of the construction loan require that construction loan proceeds be used to pay the construction contractor and remove applicable liens. Under this arrangement, payments to the construction contractor are substantially guaranteed to occur because the terms of the construction loan require payments to the construction contractor. Because this arrangement provides for substantially guaranteed payments, no substantial right to profits and the loan terms assure no risk of loss to the contractor, it is a *potential* tax avoidance arrangement or transaction under WAC 458-20-280(2). However, it is not unfair tax avoidance unless it is determined to be tax avoidance in accordance with WAC 458-20-280(3).

Example 2. Assume the same facts as in Example 1, but the value of the construction contractor's contributions of labor and materials are credited to its capital account at out-of-pocket cost plus 3% for overhead. Assume that all of the items credited to capital account are substantive credits. Under this arrangement, payments to the construction contractor are substantially guaranteed to occur because the terms of the construction loan require payments to the construction contractor. If the arrangement contains other provisions that also provide the contractor with the right to share substantial profits and require the contractor to bear significant risk of loss in the venture, then the arrangement is not an unfair tax avoidance arrangement or transaction.

Example 3. Assume the same facts as in Example 2, except that nothing in the loan documents or any other agreement require that payments be made to the construction contractor. If the arrangement also provides the contractor with the right to share substantial profits and requires the contractor to bear significant risks of loss in the venture, then the arrangement is not a tax avoidance arrangement or transaction.

Example 4. A construction contractor and a developer create a joint venture under which the developer contributes land and the construction contractor contributes labor and materials. All contributions and distributions are reflected in adjustments to the parties' capital accounts. The value of the construction contractor's capital account contributions include out-of-pocket costs of labor and materials plus 12% designated as overhead. If at any point, the value of the construction contractor's capital account exceeds a specified percentage of the total capital account balances of all members combined, and that percentage is not reduced within 30 days, the construction contractor has the right to require a buy-out by the venture (a "put option"). The purchase price of the put option is equal to the value of the unpaid balance of the construction contractor's capital account. The agreement requires the developer to guarantee the venture's payment obligation under the option. The construction contractor is also entitled up to 5% of the profits of the venture once the improved land is sold. In this example, payments to the construction contractor are substantially guaranteed as a result of the put option and the developer guarantee. In addition, the construction contractor is not entitled to substantial profits of the venture. Therefore, the arrangement is a potential tax avoidance arrangement or transaction under WAC 458-20-280 (2)(a). However, it is not unfair tax avoidance unless it is determined to be tax avoidance in accordance with WAC 458-20-280(3).

Example 5. Assume the same facts as Example 4, but the construction contractor is entitled to 50% of the profits of the venture. However, the developer has the power under the joint venture agreement to issue a call option and buy all of the construction contractor's interest in the venture at any time prior to the sale of the improved property. Under this example, the construction contractor is also not entitled to a substantial share of the profits of the venture because the construction contractor's right can be terminated by unilateral act of the developer. It does not matter whether the developer's call right is discretionary or is limited to a termination "for cause." Because the arrangement provided for guaranteed payments and does not provide the construction contractor with a vested and unconditional right to profits of the venture, the arrangement is a potential tax avoidance transaction. However, it is not unfair tax avoidance unless it is determined to be tax avoidance in accordance with WAC 458-20-280(3).

Example 6. Assume the same facts as Example 4, but the value of the construction contractor's capital account contributions includes only allowable cost of labor and materials plus 3% overhead. However, the purchase price of the put option is equal to the unpaid balance of the construction contractor's capital account plus 8% of the profits of the venture, determined as of the date the put option is exercised. The arrangement is still a potential tax avoidance arrangement. In this example, the price under the put option right is a guaranteed payment because it is guaranteed by the developer.

Example 7. A construction contractor and a developer create a joint venture to build a house, under which the developer contributes land and the construction contractor contributes labor and materials. All contributions and distributions are reflected in adjustments to the parties' capital accounts. Upon sale of the house, the venture will wind up its business, pay or provide for all debts of the venture, and distribute all funds in the following order: (i) A distribution to the construction contractor in an amount equal to the value of

its capital account; (ii) a distribution to the developer equal to the value of the amount of its capital account; (iii) substantial profits as defined in subsection (2)(d) of this rule to the construction contractor; and (iv) all remaining funds to the developer. Assume the construction contractor's rights to receive the value of its capital account and the final profits distribution are vested and unconditional, but that neither of the payments are guaranteed, secured, or otherwise protected. In this example, the construction contractor is not entitled to any guaranteed payments. In addition, the construction contractor has a right to substantial profits that are at significant risk of loss. Because none of the elements identified in subsection (2)(a) of this rule above are present, this is not a potential tax avoidance transaction.

Example 8. A construction contractor and a developer create a joint venture under which the developer contributes land and the construction contractor contributes labor and materials. Assume the construction contractor is not entitled to any guaranteed payments. Upon sale of the house, the venture will wind up its business, pay or provide for all debts of the venture, and distribute all funds X% to the developer and Y% to the construction contractor. Assume that the construction contractor's right to receive this Y% of venture profits is vested and unconditional and that the construction contractor is not entitled to any guaranteed payments. Under this example, the construction contractor is entitled to a substantial share of profits earned by the venture in the ordinary course of its business to which the construction contractor's contributions relate. This arrangement is not a potential tax avoidance arrangement or transaction because no payments, including payment of the Y% profit, are guaranteed. Therefore, the right to profits is substantial and the construction contractor also bears significant risk in the venture.

Example 9. Assume the same facts as Example 8, but the developer and an affiliate of the construction contractor enter into a separate contract for project management services. The affiliate will provide all project management and similar services through the contract, under which payment for the services is substantially guaranteed. The arrangement is not potential tax avoidance under this subsection. The project management contract will be subject to tax according to the substance of the arrangement, assuming the affiliate is responsible for construction.

(4) **Related guidance.** Nothing in this rule affects the application of WAC 458-20-170 or other department-published guidance on differentiating between speculative builders and prime contractors. Therefore, an arrangement or transaction may be considered the sale of construction services under WAC 458-20-170 or other guidance, irrespective of whether the arrangement or transaction is potential or unfair tax avoidance under this rule.

(5) **Reserved.**

NEW SECTION

WAC 458-20-28002 Disguised income arrangements described in RCW 82.32.655 (3)(b). (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) **Redirecting income as a potential tax avoidance arrangement or transaction.**

(a) **Required elements.** An arrangement that moves income is a potential tax avoidance arrangement or transaction only when all of the following elements are met:

(i) The business activities of the taxpayer or a person related to the taxpayer are of the type taxable in Washington and are integral to providing the property or services; and

(ii) The arrangement or transaction functions to move income to a person that is not taxable in Washington on that income; and

(iii) Income is received by a participant in the arrangement as consideration for property or services and that income is from a person not affiliated with the taxpayer.

Administrative services will not be considered integral to providing property or other services for purposes of this subsection.

The arrangement or transaction is unfair tax avoidance only if it meets all three of these elements and is also determined to be unfair tax avoidance under WAC 458-20-280(3).

(b) **Definitions.**

(i) "Affiliated" means under common control.

(ii) "Control" means the possession, directly or indirectly, of more than fifty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract or otherwise. A person who has the power to cause the direction of management and policies includes:

(A) Persons related to the taxpayer; and

(B) Persons with whom the taxpayer acts in concert to direct the management or policies of the entity.

(iii) "Common control" means two or more entities controlled by the same person.

(iv) "Moving" or "moves" is any act or combination of acts that result in receipt of income by a person who is not taxable in Washington on that income, when the taxpayer or a related person receives substantially all the benefit of that income. Such acts may include without limitation: An assignment, transfer, lease, or license of income-producing assets; the sale of property or services at less than market value; and capital contributions and distributions from a capital account.

(3) **Examples.**

Example 1. A Washington company ("Parent") forms a wholly owned limited liability company in Nevada ("Subsidiary"). Subsidiary has one part-time employee in Nevada, rents shared office space and has the same corporate officers as Parent. Parent causes Subsidiary to enter into sales and service contracts with customers both within and without Washington for the sale of intangible personal property and consulting services. Subsidiary hires Parent to provide all services necessary to create and support the intangible personal property, and to provide the consulting services to Subsidiary's customers. Subsidiary pays Parent a nominal amount for these services. Subsidiary transfers its remaining profits to Parent through ownership distributions. Assume the income is not taxable to Subsidiary but would be taxable if received by Parent. This arrangement is potential tax avoidance because the arrangement ensures that income received from customers for the services performed by Parent, which income would otherwise be taxable in Washington, is received by Subsidiary, not Parent. However, it is only an unfair tax avoidance transaction if it is also determined to be tax avoidance under WAC 458-20-280(3).

Example 2. Assume the same facts as Example 1, but all customers of the Subsidiary (formerly customers of Parent) are affiliates of Parent. Assume the intangible personal property and consulting services that the customers purchase from Subsidiary are not integral to any property or services provided by the customers to nonaffiliated persons. This arrangement is not potential tax avoidance because the ultimate customers of the Subsidiary in this arrangement are affiliates, rather than persons not affiliated with the taxpayer.

Example 3. After May 31, 2010, a Washington company ("Parent") forms multiple separate wholly owned Nevada subsidiaries ("S-1," "S-2," "S-3," etc.). Parent, as agent of the Nevada subsidiaries, enters into contracts with customers for services to be provided both within and without Washington. Parent limits the number of agreements per subsidiary so that each subsidiary's annual gross income is less than \$50,000. Each Subsidiary hires Parent to provide all services necessary for the Subsidiary to meet its contract obligations. Each Subsidiary pays Parent only a nominal amount for these services. Each subsidiary transfers its remaining profits to Parent through ownership distributions. This arrangement is a potential tax avoidance transaction because the arrangement ensures that income received from customers for the services performed by Parent (and otherwise taxable in Washington) is received by the subsidiaries. The arrangement further ensures that each subsidiary's gross income does not meet minimum nexus standards in Washington. However, it is only an unfair tax avoidance transaction if it is also determined to be tax avoidance under WAC 458-20-280(3).

Example 4. A Washington parent company forms a Nevada subsidiary and contributes income-producing assets to it in exchange for ownership interests. The Nevada subsidiary is adequately capitalized and uses its own employees to complete the activities necessary to sell property or services to customers. However, the parent company provides administrative services to the subsidiary at a below market cost. After paying all other costs, the Nevada subsidiary distributes its net income to the parent company. This is not a potential tax avoidance arrangement because the parent company's business activities are not integral to the subsidiary's ability to provide the property or services to its customers.

Example 5. A Washington parent company forms a Delaware subsidiary that is adequately capitalized and carries on substantial business

activities using its own property or employees. Sales representatives employed by the Washington parent company call on potential customers and enter into product sales contracts on behalf of the Washington parent. The Washington parent then transfers those contracts to the subsidiary, and the subsidiary fulfills the orders and receives the income. After paying its costs, the Delaware subsidiary distributes its net income to parent. This arrangement is a potential tax avoidance arrangement because the Parent's sales representatives' activities are integral to the subsidiary's ability to provide the property or services to its customers. However, it is only an unfair tax avoidance transaction if it is also determined to be tax avoidance under WAC 458-20-280(3).

Example 6. A Washington manufacturer wholesales its products both within and without Washington. The Washington manufacturer forms an Idaho subsidiary company and transfers all of its wholesale contracts to it. The manufacturer causes the subsidiary to purchase and hold all raw materials necessary to manufacture the products. The subsidiary then hires the Washington manufacturer to act as a processor for hire. The subsidiary, as owner of the manufactured products, sells them under the transferred wholesale contracts. Assume the subsidiary has nexus with Washington. This arrangement is not a potential tax avoidance arrangement because it does not function to move income from the sale of goods or services from an entity taxable in Washington to a related entity that is not taxable in Washington on that income. The subsidiary is taxable on all sales in Washington in the same manner as was the manufacturer.

Example 7. Assume the same facts as Example 6, except Parent is not a processor for hire. The Washington manufacturer forms a Washington subsidiary company and transfers all of its sales contracts to it. The subsidiary purchases all of the products made by the manufacturer at a reasonable discount. The subsidiary then sells the products under the transferred contracts. This arrangement is not a potential tax avoidance arrangement because the subsidiary is taxable on all sales in Washington in the same manner as was the manufacturer. The arrangement does not function to move income from the sale of goods or services from an entity taxable in Washington to a related entity that is not taxable in Washington on that income.

Example 8. Assume the same facts as Example 7, but the subsidiary is an Oregon company with no nexus with Washington. Assume that the products are not warehoused in Washington, but are immediately shipped upon production and that the Oregon subsidiary has no other activities that create nexus with Washington. This arrangement is a potential tax avoidance arrangement because it functions to move income from the sale of the product from the manufacturer to the Oregon subsidiary. However, it is only an unfair tax avoidance transaction if it is also determined to be tax avoidance under WAC 458-20-280(3).

NEW SECTION

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.