

**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 pa-

rent. 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).

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). WSR 15-09-004, § 458-20-28002, filed 4/2/15, effective 5/3/15.]