Tax Avoidance Provisions 201- 203

2ESSB 6143 & Chapter 23, Laws of 2010

Joint Tax Avoidance Review Committee

- JTARC Purpose: Address implementation, oversight, and other issues related to sections 201 through 203 of 2ESSB 6143

- General Nature: Sections 201 through 203
  - Section 201: Tax Avoidance Transactions
  - Section 202: Safe Harbor for Certain Prior Tax Avoidance Transactions
  - Section 203: Penalty for Engaging in a Tax Avoidance Transaction

Intent

"It is the legislature's intent to require all taxpayers to pay their fair share of taxes. To accomplish this purpose, it is the legislature's intent to stop transactions or arrangements that are designed to unfairly avoid taxes."

Section 201(1)

Section 201 - Tax Avoidance

- **Tax Avoidance:** Can be generally described as engaging in a particular transaction or arrangement for the primary purpose of avoiding state taxation.
- **Factors that may be considered:**

“. . . [T]he department may consider:

(a) Whether an 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;

(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 entities' relative contributions to the work that generates income;

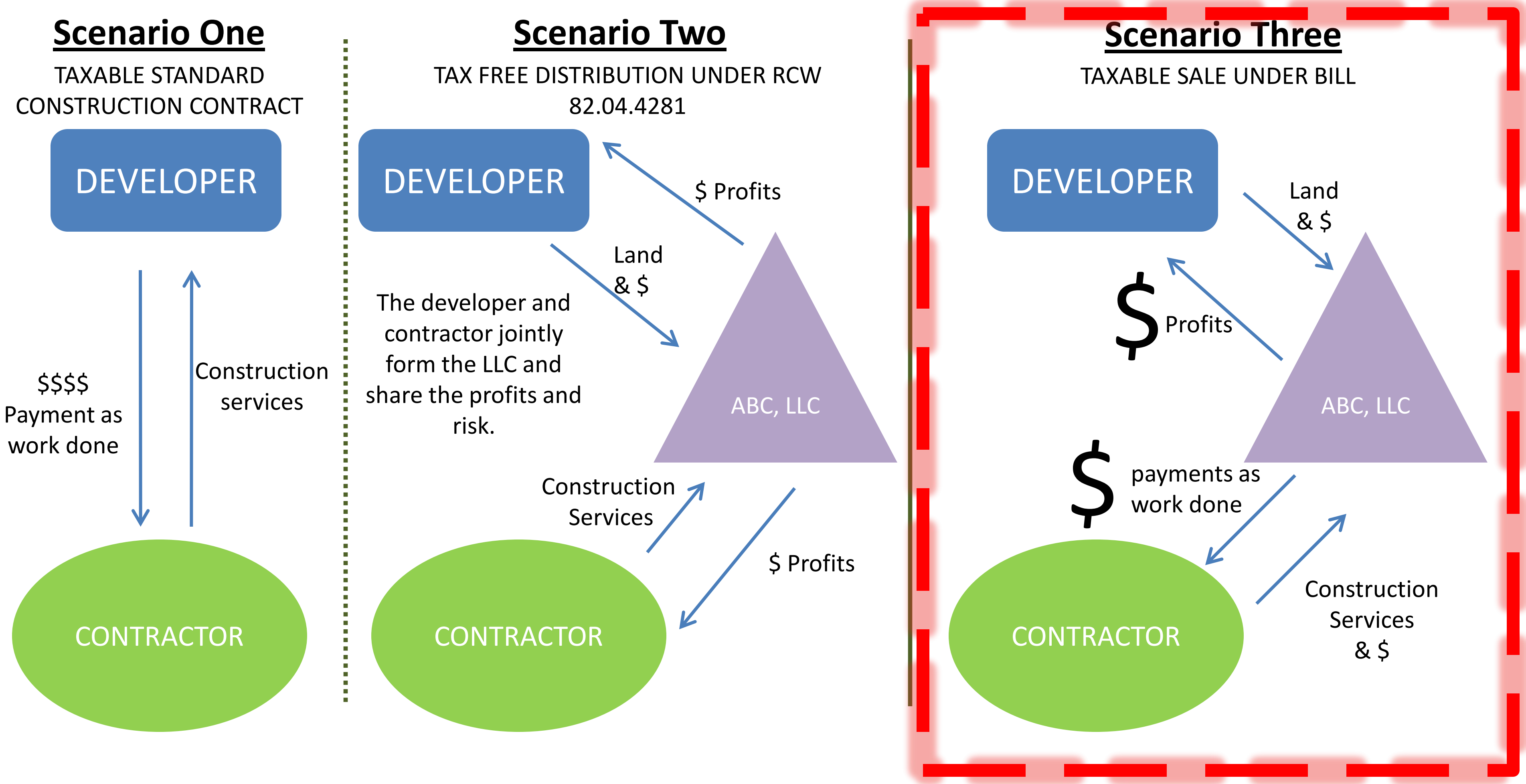
(e) The location where work is performed; and

(f) Other relevant factors.”

Section 201 - Tax Avoidance

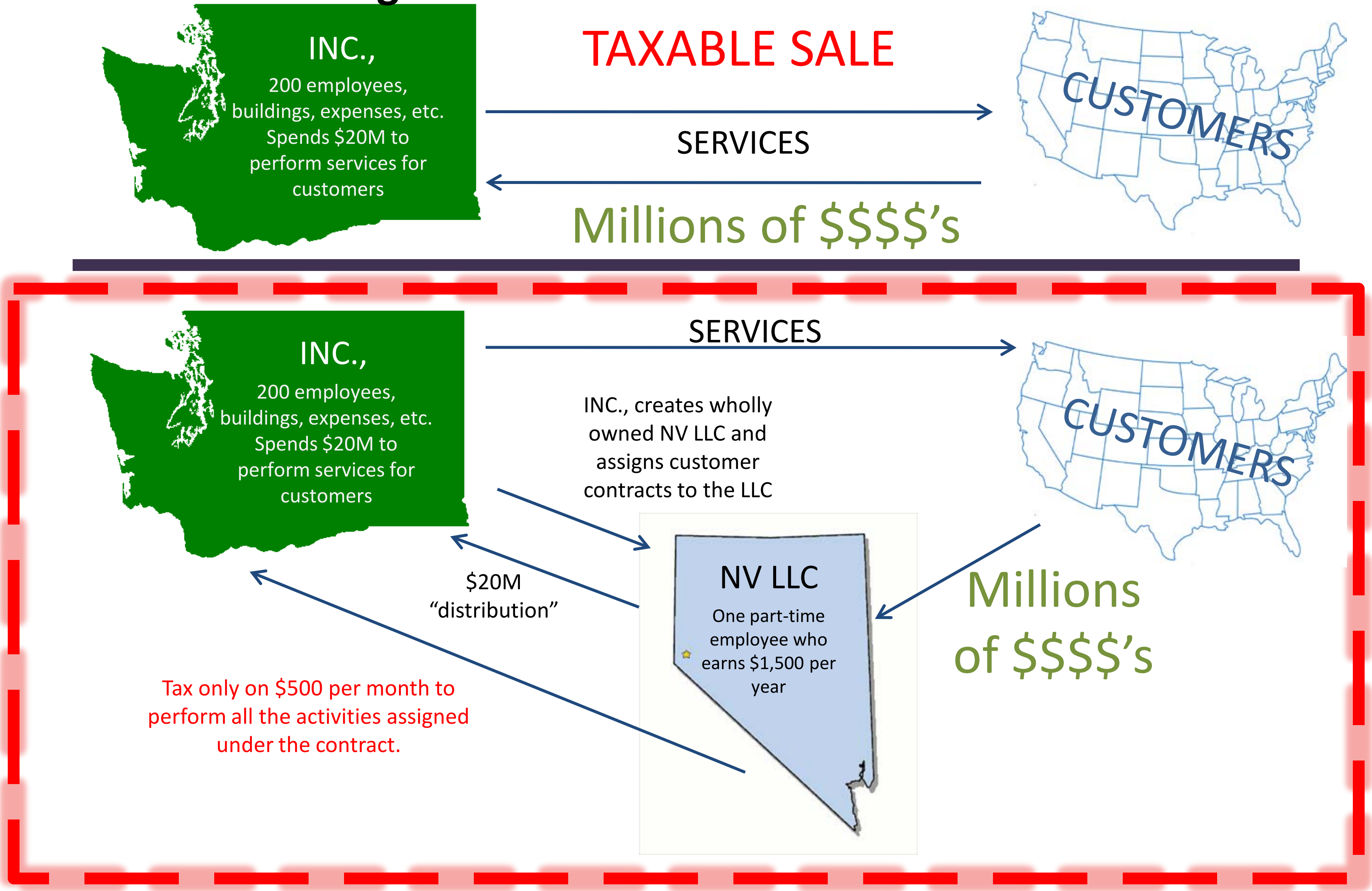
- **Three Specific Types of Arrangements or Transactions:**
  - **Arrangements to Avoid Sales & B&O Taxes on Construction Services:** A contractor and developer form an LLC where the contractor has minimal risk and does not share in the profits. Distributions from the LLC to the contractor are tax free.
  - **Arrangements to Avoid B&O Taxes**: A WA taxpayer creates an out-of-state subsidiary and assigns customer contracts to the subsidiary. Distributions to the WA company from the subsidiary are tax free.
  - **Arrangements to Avoid Sales/Use Taxes on TPP:** A WA taxpayer vests legal title in tangible personal property to a business entity such as an LLC, but maintains control over the use of property. Sales and use taxes are avoided.

Arrangements to Avoid Sales & B&O Taxes on Construction Services



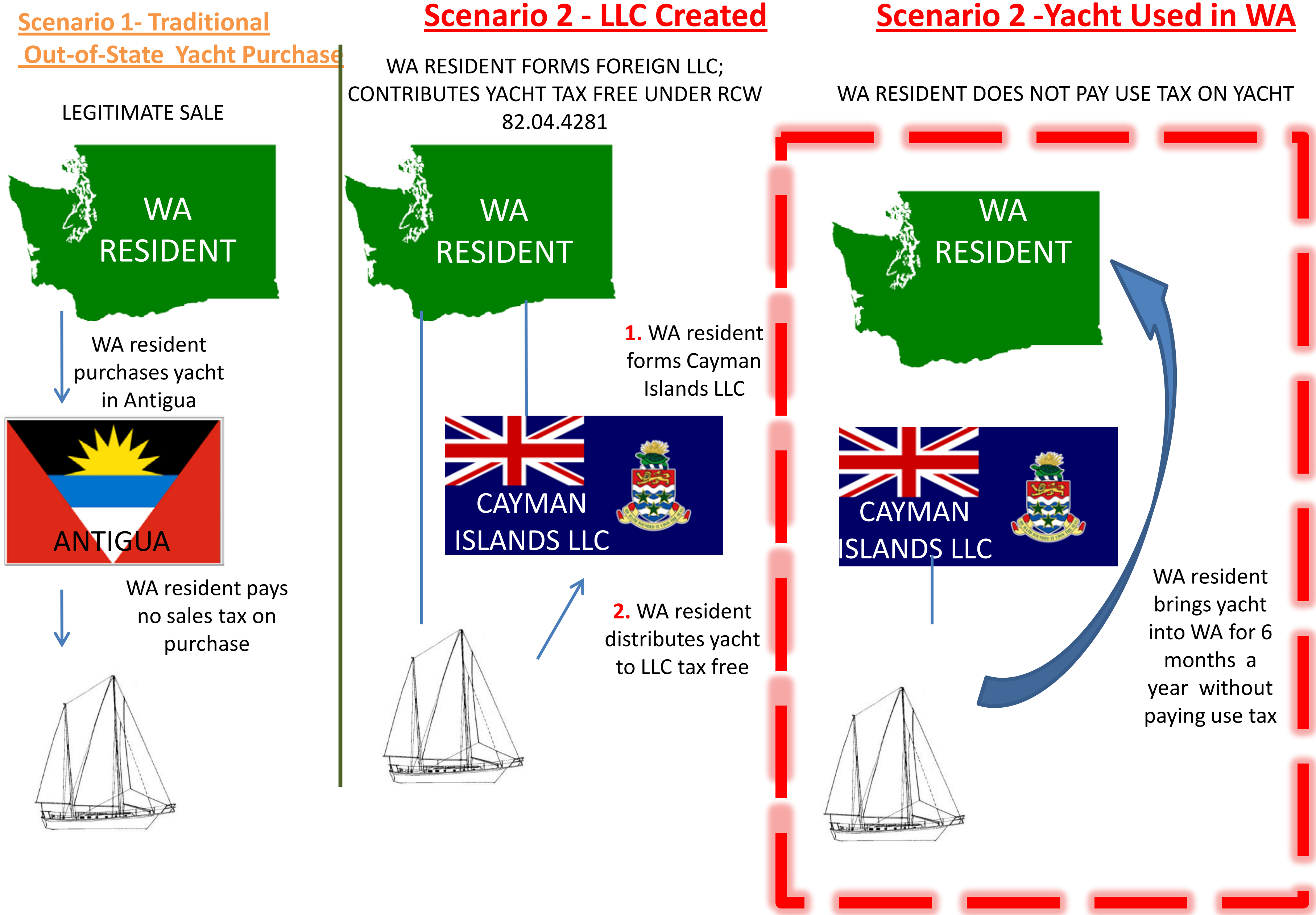
Avoidance occurs in Scenario Three because the Contractor's "distributions" are essentially guaranteed payments for the construction services; the Contractor does not share substantial profits and has little to no risk in the venture.

Arrangements to Avoid B&O Taxes



This is tax avoidance because INC., is receiving $20M per year but only paying tax on $6,000.

Arrangements to Avoid Sales/Use Taxes on TPP



Section 202 - Safe Harbor Provisions

- **General Rule:** DOR may pursue transactions or arrangements that would have been taxable in tax periods on or after January 1, 2006.

- **Exceptions to retroactive application:**
  - Specific Written Instructions
  - Published Department Determinations
  - Any other document made available to the public

Section 203 - Tax Avoidance Penalty

- 35% Penalty on Additional Tax
- Exception:
  - *"The department may not assess the penalty under this subsection if, before the department discovers the taxpayer's use of a transaction described under section 201(3) of this act, the taxpayer discloses its participation in the transaction to the department."*