BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment	)	F I N A L D E T E R M I N A T I O N
	)	
	)	No. 97-174ER
	)	
. . .	)	Registration No. . . .
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[1] RULE 106, RULE 203; RCW 82.04.070, 82.04.080, 82.04.090: CONTRIBUTIONS TO CAPITAL VERSUS SALES. Where a parent corporation procures the services of third parties for the benefit of a subsidiary and treats the costs of those services as loans to the subsidiary, calculating interest thereon, the parent may not treat the cost of the services as contributions to capital, exempt from taxation under Rule 106. The transactions are sales from the parent to the subsidiary and subject to state excise taxes.

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.

NATURE OF ACTION:

A group of related taxpayers request executive level reconsideration of Det. No. 97-174. Specifically, the parent corporation protests the assessment of business and occupation ("B&O") tax on amounts it paid to contractors performing construction services relating to [energy] projects licensed to its subsidiaries. Initially, the taxpayers protested the assessment of retail sales or use tax on costs relating to the construction of these [energy] projects, however, during the hearing the taxpayers withdrew this portion of the executive level appeal.[1]

FACTS:

A.L.J. Coffman -- The facts of this appeal are fully stated in Det. No. 97-174 and will be repeated here only as necessary for this determination. We stated in Det. No. 97-174:

> The taxpayers are related corporations commonly owned by . . . ("Parent"). . . . ("Taxpayer 1") was acquired by Parent in 1988. Taxpayer 1 held 100% of the stock of several corporations including . . . ("Taxpayer 2") and . . . ("Taxpayer 3").
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> . . .
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> Taxpayer 1 is a developer of [energy] sites. At the time Taxpayer 1 was acquired by Parent, it had seven 100% owned subsidiaries. These subsidiaries were created for the purpose of applying for FERC licenses/permits to develop small [energy] projects. Taxpayer 1 explains that the sole reason for the creation of the subsidiaries is that the FERC regulations make it very difficult to transfer permits. However, a transfer could be accomplished by selling the stock in the corporation holding the permit. Taxpayer 1's seven subsidiaries held permits for 48 sites. Each subsidiary held between 1 and 16 permits. Since Taxpayer 1's acquisition by Parent, nine additional subsidiaries have either been formed or acquired and each holds (or held) only one permit.
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> A FERC permit gives the holder the exclusive right to investigate the viability of a specific energy project. This can be an expensive and time-consuming venture. When the investigation is complete, and if the project is determined to be viable, FERC can issue a license to build [project]. Taxpayer 1 entered into contracts with Contractor and others to perform the investigation and construction of the projects. Taxpayers 2 & 3 were not parties to these contracts.
>
> Taxpayer 1 maintained its own books and records and those of each subsidiary. The Audit Division states that the books and records of Taxpayers 2 & 3 consist of a balance sheet and nothing more. Taxpayer 1 used its checking account to pay all of the costs associated with each project. Taxpayers 2 & 3 do not maintain any bank accounts.
>
> Parent provides funding to Taxpayer 1 for all of its operations. The funding consists of either loans to Taxpayer 1 or additional capital contributions. When the purpose of the funding from Parent was to support services relating to a FERC permit/license, the funding was treated as a loan from the Parent to Taxpayer 1. Taxpayer 1 then treated the

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

> amount it expended on a particular project as a loan to the appropriate subsidiary, and showed in its books the loan and capitalized interest as it accrued on the loans.
>
> Costs are accounted for by project/permit. The primary reason for this accounting is that, as a utility, Parent is allowed to recover its costs in the rate setting process. Thus, the taxpayers attempt to include all costs associated with a project including the cost of money.
>
> Under FERC regulations that existed in 1988, once the plant was completed, the subsidiary was required to either transfer it to Parent (a regulated utility) or to a third party. Subsequently, the FERC regulations were changed and now allow the subsidiaries to operate the plants.

In Det. No. 97-174, we found that Taxpayer 1 was liable for B&O tax on amounts that it paid to contractors for pre-construction and construction work that benefited Taxpayers 2 & 3. In reaching this conclusion, we found that there was a contract (actual or implied) between Taxpayer 1 and each of its subsidiaries. Taxpayer 1 argues that it was merely making capital contributions to its subsidiaries when it procured the services of third parties relating to the energy projects developed in the name of either Taxpayer 2 or Taxpayer 3.

Additionally, we found that Taxpayer 1 or Taxpayer 2 or 3, as the case may be, was liable for retail sales tax or use tax on the costs of constructing the [energy] projects. Further, we found that to the extent that Taxpayer 1 paid retail sales tax, a credit would be available to Taxpayer 2 or 3 and if Taxpayer 2 or 3 paid use tax, a credit would be available to Taxpayer 1. In this way, the Department would collect the tax only once.

The taxpayers initially objected to the finding that retail sales or use tax applied to the construction costs. However, during the hearing, they withdrew their appeal of this issue. Because there are no other issues on appeal involving Taxpayers 2 and 3, their appeals are dismissed by this determination.

ISSUE:

Where a parent corporation procures the services of third parties for the benefit of a subsidiary, can the parent treat the costs of those services as a contribution to capital and, at the same time, treat those costs as a loan to the subsidiary and capitalize the accrued interest?

DISCUSSION:

Generally, transfers of capital assets between a parent corporation and its subsidiary are not subject to retail sales or use tax when the parent has paid these taxes prior to the transfer. Likewise, B&O tax is not due on such transfers. <u>See</u> WAC 458-20-106 (Rule 106) which states:

> A transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business. The following examples are instances when the tax will not apply.
>
> (1) Transfers of capital assets between a corporation and a wholly owned subsidiary, or between wholly-owned subsidiaries of the same corporation.

The premise supporting Rule 106 is that such transfers are adjustments to the beneficial interest in the subsidiary and not sales. Det. No. 87-212, 3 WTD 259 (1987); Det. No. 91-292, 11 WTD 483 (1991). Thus, to the extent that Taxpayer 1 has made transfers of capital assets to Taxpayers 2 & 3, without an obligation to pay for the assets, the transfers are not taxable.

[1] A taxable transaction occurs when there is the provision of services or transfer of property for consideration. RCW 82.04.070, .080, and .090. Taxpayer 1 treated Taxpayers 2 & 3 as having borrowed the value of these assets from Taxpayer 1. Taxpayer 1 calculated interest on each subsidiary's 'loan balances'. Thus, the transfers of the property and services to Taxpayers 2 & 3 were for consideration (the obligation to repay the loans plus interest). Therefore, the transfers were not capital contributions and Rule 106 does not apply.

Transactions for consideration between related corporations are sales and subject to B&O and retail sales tax. Washington Sav-Mor Oil Co. v. Tax Comm., 58 Wn.2d 518, 364 P.2d 440 (1961); WAC 458-20-203. Thus, we find that Taxpayer 1 is liable for service and other B&O tax for the acquisition of "licensing services . . .". Det. No. 97-174, page 8. Additionally, Taxpayer 1 is liable for retailing B&O tax on the construction costs.

DECISION AND DISPOSITION:

The petitions of Taxpayers 2 & 3 are dismissed. The petition of Taxpayer 1 is denied.

Dated this 29th day of May 1998.