

Cite as Det. No. 02-0145R, 22 WTD 257 (2003)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 02-0145R
)	
...)	Registration No. ...
)	
)	FY ... & FY ...
)	Docket No. ...
)	

RULE 178; RCW 82.12.020: USE TAX – REVOCABLE LIVING TRUSTS – PERSONS LIABLE – SUBSTANCE OVER FORM. As grantor, trustee, and beneficiary of a revocable living trust, the taxpayer had the exclusive right to enjoy, use, profit from, or sell the property, as would any owner, and was liable for the payment of use tax as an owner of the property, measured by the purchase price.

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.

Mahan, A.L.J. – An individual who is the both the grantor and trustee under a revocable living trust seeks reconsideration of Det. No. 02-0145, which sustained a use tax assessment against her and her husband. Based on the arguments and evidence presented, we deny the petition for reconsideration.¹

ISSUE

Assuming that a trustee for a revocable living trust, rather than the taxpayers individually, holds legal title to a yacht purchased in Washington, can the taxpayers be held personally liable for use tax upon the nonexempt use of the yacht in Washington?

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

FINDINGS OF FACT

Taxpayer . . . (“taxpayer”) and her husband (collectively “taxpayers”) are [State A] residents. On August 19, 1997, they entered into a Yacht Purchase and Sale Agreement for the purchase of the yacht . . . for \$. . . , with delivery to occur in Washington, and paid a \$. . . deposit. A bill of sale dated September 15, 1997 identifies the buyer as “[Taxpayer], as trustee of the [Taxpayer] Living Trust” (living trust), rather than the taxpayers as the buyer. The referenced living trust is a trust established in [State A] according to documents dated June 23, 1994. No sales tax was paid on the purchase by either the taxpayers or the living trust.

After the purchase, the taxpayers entered into a moorage agreement for the yacht and paid the moorage fee. The yacht was moored and used in Washington after the purchase. On November 6, 1997, the taxpayers also paid a transfer fee to the Department of Transportation, United States Coast Guard, which issued a Certificate of Documentation for the yacht. The owner is identified as “[Taxpayer] trustee of the [Taxpayer] Living Trust.”

On October 30, 1998, the taxpayer took title to a residence in Washington as trustee of the living trust. The taxpayer and her husband have used the property as a second residence and have used the yacht in Washington for various extended periods of time since its purchase in 1997. Use in Washington was not under a lease.

On November 30, 2001, the Department of Revenue (Department) issued a use tax assessment against the taxpayer and her husband in the amount of \$. . . , which included interest and penalties. The Department also issued a Watercraft Excise Tax (WET) assessment under RCW 82.49.010 against the taxpayer and her husband in the amount of \$ On December 31, 2001, the taxpayer paid \$. . . against the WET assessment.

The taxpayers now contend that the Department assessed the wrong party, i.e., the trust should have been assessed the tax, and the Department is now barred by the statute of limitations from assessing the tax against the trust.

The living trust is a revocable inter vivos trust – an amendable trust agreement used by many for the stated purpose of avoiding probate. *See generally* 1 A. Scott, *Law of Trusts* § 17 (4th ed. 2000). The taxpayer was the trust settlor, acts as the sole trustee, holds legal title to the property as trustee, and is the sole current beneficiary of the trust for life. As grantor, the taxpayer is the beneficiary of the trust, may receive all income of the trust, up to and including the principal, and has the power to revoke the trust at any time. As trustee, the taxpayer had the right to sell, invest, and otherwise deal with the trust property.

Under joint federal income tax returns filed by the taxpayers, income from the trust is treated as the taxpayers’ income. The taxpayers also file [State A] resident income tax returns.

ANALYSIS

A sales tax is imposed on each retail sale within the state. RCW 82.08.020. A use tax, levied at the same rate as the sales tax, is imposed on any person who uses an item of tangible personal property as a consumer. RCW 82.12.020. A consumer is exempt from the use tax if he or she has paid sales tax. RCW 82.12.0252.

RCW 82.08.0266 provides a limited exemption from retail sales tax for watercraft requiring coast guard registration, purchased by nonresidents, and which leave Washington within 45 days after delivery in Washington. Should the watercraft not leave Washington within 45 days after delivery, deferred sales tax or use tax becomes due. WAC 458-20-238 (Rule 238).^[2] Use tax may also become due on other uses of watercraft by nonresidents. *Id.* To the extent the yacht's purchase and use in Washington may have been exempt from sales or use tax when first purchased and used, its later use subjected it to tax in Washington.

The term "person" for Washington excise tax purposes is defined to include a trust, and trusts are generally treated as separate taxable entities for Washington tax purposes. *See* RCW 82.04.030. The term does not include trustees other than trustees in bankruptcy. *Id.* Accordingly, the taxpayer, when acting as grantor or trustee, would not be treated as a separate person for excise tax purposes. At issue in this case is whether the taxpayer can be held personally liable for use tax as the grantor and beneficiary under a revocable living trust or as the trustee of such a trust.³

In a trust relationship, ownership is divided into two elements, with the beneficiary possessing the equitable ownership interest in the trust property and the trustee possessing the legal title to the property. *See* Restatement (Second) of Trusts §§ 1, 3 (1959). In the present case, the taxpayer is the sole beneficiary of the trust during her lifetime, has the right to revoke the trust at any time and vest title in her name, and she also holds legal title as trustee. Her interests are close to full ownership.

A similar conclusion was reached in an Attorney General Opinion (AGO) regarding the eligibility of a grantor and beneficiary of a revocable trust to use an exemption available to property owners.⁴ In concluding the grantor was entitled to the exemption, the attorney general reasoned:

The trustor [grantor] can withdraw the residence from the trust at any time, and retains the unconditional right to revoke the trust itself upon three days' written notice. Further, the trustor retains the obligation to pay any and all expenses connected with the residence, as would an ordinary fee owner, and retains all rights of use as are held by an ordinary fee owner.

^[2] The record before us does not reflect whether the yacht was removed from the state within 45 days; however, we do not need to determine this for purposes of this appeal.]

³ Certain abusive trust arrangements have been treated as sham arrangements, leaving the individuals involved subject to tax. *See, e.g.,* Det. No. 92-133, 12 WTD 171 (1993); *see also* Rev. Notice 97-24, 1997-1 C.B. 409. There is no evidence here to indicate the trust was a sham, only that it was set up to avoid probate in [State A].

⁴ . . .

As a practical matter, under the trust agreement the owner [grantor] is in the same position with respect to his residence as he would be if he had simply provided in his will that his residence would be left to certain designated beneficiaries.

AGO 67-03 No. 28 (1967).⁵

Similarly, in the present case, the taxpayer under the trust agreement is in the same position with respect to the yacht as she would be if she had simply provided in her will that the yacht would be left to certain designated beneficiaries. The use of a living trust as a mechanism to avoid probate is not, by itself, sufficient for us to conclude the taxpayer should not be treated as an owner or purchaser of the yacht for purposes of RCW 82.12.020.

This conclusion is in accord with the treatment of grantor trusts under federal income tax law. For purposes of federal income tax, the law has long required the income of a trust to be taxed to the grantor if the grantor has the power to vest the trust corpus in the grantor's name or the power to receive the income from the trust. For example, in the case of *Corliss v. Bowers*, 281 U.S. 376, 378 (1930), Corliss argued that he was not subject to tax on income from a revocable trust because the legal estate was in the trustee and the equitable interest in his wife. The court stated: "But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed -- the actual benefit for which the tax is paid." See also *Helvering v. Clifford*, 309 U.S. 331, 337 (1940), where the court reasoned: "where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus To hold otherwise would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties" These principles were later codified under the Internal Revenue Code. See I.R.C. §§ 676, 677.

The reasoning employed in the federal income tax cases involved consideration of the attributes of ownership and not merely the form under which title was held. Under Washington law, substance may also be considered in certain circumstances and not just the form. See *Time Oil Co. v. State*, 79 Wn. 2d 143, 146, 483 P.2d 628 (1971), where the court stated:

[I]n some other fields of legal liability revolving about the manner, time, and place of passage of possession and actual title to the petroleum products involved the argument might well prevail. However, here we are not concerned with the technicalities of the transference of title and possession. Rather, our primary concern is whether the transactions involved constitute a taxable business activity within the contemplation of the business and occupation tax statutes.

⁵ Based on similar reasoning, a beneficiary of a grantor trust was determined to be eligible for a property tax rebate in Vermont. Formal Ruling No. 92-6, Vt. Tax LEXIS 6 (1992).

In a similar manner, the question of ownership for use tax purposes in this case does not revolve around technicalities of title for probate avoidance purposes. For the Department to have treated the taxpayer as an owner, one who is personally liable for payment of the tax, is consistent with the substance of the activities and transactions at issue in this case. In contrast, in order for us to hold the taxpayer was not an owner, we would have to ignore the overwhelming attributes of ownership held by the taxpayer and elevate form over substance.

The taxpayer's contention that Det. No. 92-133, 12 WTD 171 (1993) limits the application of the substance over form provisions to sham transactions is not correct. Det. No. 92-133 concerned a living trust set up by a Washington resident and used for the purchase of a motor home in Oregon. In considering substance over form, that determination concluded:

[T]he substance of the trust was that the taxpayers in fact owned the motor home. They treated it as their personal property. They paid the maintenance and insurance expenses relating to the trust property. The trust was created by them, for their benefit, they were the trustees, and they retained the power to revoke or amend it any time.

Although that determination went on to conclude the living trust was not set up for probate avoidance purposes, but to avoid excise tax, that additional conclusion was not necessary to the outcome.

Our concern in this case is whether the taxpayer is liable for payment of the use tax and the measure of the tax. The use tax is imposed for the privilege of using personal property in Washington as a consumer. RCW 82.12.020. The measure of the use tax is the "value of the article used." RCW 82.12.020. That phrase generally means the consideration given by the purchaser to the seller. RCW 82.12.010(1)(a). . . .

The taxpayer used the yacht as a consumer in Washington over an extended period of time. As grantor, trustee, and beneficiary of the revocable living trust, the taxpayer had the exclusive right to enjoy, use, profit from, or sell the property, as would any owner. . . . We conclude the taxpayer used the property as an owner or purchaser and was liable for the payment of use tax measured by the purchase price.

DECISION AND DISPOSITION:

We deny the taxpayer's petition for reconsideration.

Dated this 5th day of February, 2003.