

No. 65113-7-I

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**COURT OF APPEALS, DIVISION I  
OF THE STATE OF WASHINGTON**

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**GETTY IMAGES (SEATTLE), INC.,**

**Appellant,**

**v.**

**CITY OF SEATTLE, DIRECTOR OF THE DEPARTMENT OF  
EXECUTIVE AFFAIRS, DIVISION OF REVENUE AND  
CONSUMER AFFAIRS, and CITY OF SEATTLE, OFFICE OF THE  
HEARING EXAMINER,**

**Respondent.**

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**APPELLANT'S REPLY BRIEF**

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**TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| I. Restatement of the Case .....   | 1           |
| A. Introduction .....  | 1           |
| B. Clarification of Certain Facts .....  | 1           |
| II. Summary of Argument .....  | 6           |
| III. Argument .....  | 7           |
| A. Under the City Ordinance, Only "Consideration"<br>Received or Entitled to Be Received Is Includable<br>in the Measure of Tax .....  | 7           |
| B. The Director's Court Authorities Are Inapposite.....  | 9           |
| C. The Director's Reliance on State Department of<br>Revenue Determinations Is Equally Misplaced.....  | 12          |
| D. Washington Courts Have Expressly Refused to<br>Apply the Federal Substance Over Form Doctrine<br>and Have Not Adopted Their Own Version Either .....                                      | 14          |
| E. The Washington Courts' Decisions in Simpson<br>Investment, Weyerhaeuser, and Estep Provide the<br>Necessary Guidance in This Case .....   | 17          |
| F. The Washington State Legislature Has<br>Acknowledged that Prior Law Did Not Include Any<br>Substance Over Form Doctrine, and that Income<br>Should Not Be Imputed Between Affiliates..... | 23          |
| IV. Conclusion.....  | 24          |

## TABLE OF AUTHORITIES

|  | Page           |
|--|----------------|
| <b>Cases</b>   |                |
| <i>Ban-Mac, Inc. v. King County</i> , 69 Wn.2d 49, 496 P.2d 694 (1966) ...   | 21, 22         |
| <i>Chicago Bridge &amp; Iron Co. v. Dep't of Revenue</i> , 98 Wn.2d 814,<br>659 P.2d 463 (1983) .....                            | 9, 10          |
| <i>Engine Rebuilders, Inc. v. State</i> , 66 Wn.2d 147, 401 P.2d 628<br>(1965) .....   | 9              |
| <i>Estep v. King County</i> , 66 Wn.2d 76, 401 P.2d 332 (1965) .....   | 15, 16, 18, 19 |
| <i>Ford Motor Co. v. Seattle Exec. Servs. Dep't</i> , 160 Wn.2d 32, 156<br>P.3d 185 (2007) .....                                 | 10             |
| <i>Gregory v. Helvering</i> , 293 U.S. 465 (1935) .....  | 18             |
| <i>Quill Corp. v. North Dakota</i> , 504 U.S. 298 (1992) .....   | 8              |
| <i>Rice's Toyota World, Inc. v. Comm'r</i> , 752 F.2d 89 (4th Cir. 1985) .....   | 16             |
| <i>Simpson Inv. Co. v. Dep't of Revenue</i> , 141 Wn.2d 139, 3 P.3d 741<br>(2000) .....  | 18, 19         |
| <i>Simpson Inv. Co. v. Dep't of Revenue</i> , 92 Wn.App. 905, 965 P.2d<br>654 (1998), <i>rev'd</i> , 141 Wn.2d 139 (2000) .....  | 18             |
| <i>Simpson Timber Co. v. Dep't of Revenue</i> , Board of Tax Appeals<br>No. 30192, 1986 Wash. Tax Lexis 55 (1986) .....          | 22             |
| <i>Time Oil Co. v. State</i> , 79 Wn.2d 143, 483 P.2d 628 (1971) .....   | 11, 12         |
| <i>U.S. Tobacco Sales &amp; Mktg. Co. v. State, Dep't of Revenue</i> , 96<br>Wn. App. 932, 982 P.2d 652 (1999) .....             | 22             |
| <i>United Parking v. Dep't of Revenue</i> , Board of Tax Appeals No.<br>42670, 1994 WL 321397 (Wash. B.T.A. June 14, 1994) ..... | 11, 22         |
| <i>Weyerhaeuser Co. v. State Dep't of Revenue</i> , 106 Wn.2d 557, 723<br>P.2d 1141 (1986) .....                                 | 19, 20, 21     |

**TABLE OF AUTHORITIES**  
(continued)

|   | <b>Page</b>  |
|---|--------------|
| <b>Statutes</b>   |              |
| I.R.C. § 482.....   | 14           |
| Laws of 2010, 1st Spec. Sess., ch. 23, § 201 .....  | 17, 23       |
| Laws of 2010, 1st Spec. Sess., ch. 23, § 201(3)(b).....   | 24           |
| RCW 82.04.080 .....   | 8            |
| RCW 82.04.090 .....   | 8            |
| RCW 82.12.010(7)(a).....  | 13           |
| RCW 82.12.020(4) .....  | 13           |
| Sec. 9, City of Seattle Ord. 123063 .....   | 17           |
| SMC 5.30.035(D) .....   | 1, 7, 23, 25 |
| SMC 5.30.060(F).....  | 8            |
| SMC 5.30.060(G)(2).....   | 13           |
| SMC 5.45.050(B) .....   | 13           |
| SMC 5.45.085.....   | 23           |
| SMC 5.45.085(B)(1).....   | 16           |
| <b>Other Authorities</b>  |              |
| AGLO 1977, No. 6 .....  | 23           |
| AGO 1975 No. 6 .....  | 15           |
| <i>Discharge of Indebtedness, Bankruptcy and Insolvency, 540 Tax</i><br>Mgmt. Portfolio 3rd (BNA) A-1 (2009)..... | 8            |
| Final Bill Report (2ESSB 6143).....   | 23           |
| HB 2970 § 201(1)(e).....  | 24           |

**TABLE OF AUTHORITIES**  
**(continued)**

|  | <b>Page</b> |
|--|-------------|
| http://bta.state.wa.us .....   | 12          |
| http://taxpedia.dor.wa.gov .....   | 4           |
| IRS Rev. Rul. 76-187, 1976-1 CB 97.....                                  | 17          |
| IRS Rev. Rul. 89-101, 1989-2 CB 67.....                                  | 16          |
| Wash. Dep't of Revenue Det. No. 87-212, 3 WTD 259 (1987) .....           | 13          |
| Wash. Dep't of Revenue Det. No. 90-397, 10 WTD 341 (1990).....           | 12          |
| Wash. Dep't of Revenue Det. No. 91-319, 11 WTD 511, 513<br>(1992) .....  | 13, 19      |
| Wash. Dep't of Revenue Det. No. 92-133, 12 WTD 171 (1993).....           | 12          |
| Wash. Dep't of Revenue Det. No. 93-303, 14 WTD 054 (1994).....           | 13, 15      |
| Wash. Dep't of Revenue Det. No. 94-272, 15 WTD 78 (1995).....            | 20          |
| Wash. Dep't of Revenue Det. No. 94-320ER, 23 WTD 307 (2004) .....        | 12          |
| Wash. Dep't of Revenue Final Det. No. 86-309A, 4 WTD 341<br>(1987) ..... | 4, 8        |

## **I. Restatement of the Case**

### **A. Introduction**

Getty Images (Seattle), Inc. ("Getty Seattle") provides intercompany administrative services through Getty Images (Management Company), LLC ("Getty Management") for \$1 million annually. This amount represents the entirety of Getty Seattle's consideration – the parties intended for there to be no more consideration, and no more was paid.

Throughout the audit period, Getty Seattle also borrowed cash through the group's cash management system. The Director admits that these borrowed funds are debt, but nevertheless claims that these funds are also taxable. Debt proceeds are not consideration under SMC 5.30.035(D) ("City Ordinance"). In addition, Washington courts have refused to adopt common law principles that would permit the Director to recharacterize the funds as consideration.

### **B. Clarification of Certain Facts**

The material facts are not in dispute. Getty Seattle contracted to provide administrative services through Getty Management for only \$1 million annually. CP 75. Neither party to the arrangement had any intent for anything more to be paid. CP 352. In fact, no more consideration was paid or entitled to be received.

Most, if not all, affiliated groups around the country use cash management systems in the ordinary course of business to transfer cash on a daily basis between affiliates. These transfers do not represent payment for services. CP 353-357 (testimony of Mr. Dunn about his experience while working with and auditing hundreds of companies with cash management systems as a CPA as well as his explanation of the Getty cash management system); CP 166 and Appendix E to Brief of Appellant (Washington State Department of Revenue explanations of cash management systems); Appendices A through D to Brief of Appellant (*Simpson Inv. Co. v. Dep't of Revenue* briefs).

Even though the facts are not in dispute, the Director misleads the court in several respects with its recitation of the facts. First, the Director claims that Getty Seattle could not perform these services without receiving cash management transfers. Director's Brief at 5. However, both Mr. Dunn and the Director's auditor, Mr. Springer, testified to the contrary. Mr. Dunn testified that Getty Seattle could have received a capital contribution, a subsidiary distribution, or a third party loan. CP 387-388. Mr. Springer testified the same way. CP 414-415. More on point, Mr. Springer was asked "if Getty Seattle could have borrowed funds from a bank and gotten proceeds tax free . . . why [could it] not borrow

from its own affiliates? A. I would assume it – it could borrow from its own affiliates, yes." CP 415.

Second, the Director claims that Getty Management was created for "the express purpose of avoiding City taxes," Director's Brief at 22, but Mr. Dunn testified that "the **primary reason** was to – to effect the management charges to the foreign affiliates, with the secondary reason being to avoid an **increase** in tax in the state of Washington." CP 382 (emphasis added). These "management charges to the foreign affiliates" refer to a 2001 company-wide reorganization. CP 363-365. Under that reorganization, Getty Management entered into formal agreements for the provision of intercompany services provided to the foreign affiliates. CP 285 (Stip. of Facts ¶ 12). The agreements were necessary in order for the foreign affiliates to take an offsetting deduction for foreign taxes. CP 367-369. These agreements, however, if entered into with Getty Seattle, would have increased the company's Washington state taxes, and as a result, the group chose a more tax efficient structure. CP 364-365, 368.

Third, the Director claims that Getty Images' former Vice President of Tax, Mr. Cristallo, conceded during the audit that the arrangement between Getty Management and Getty Seattle related to local taxes. Director's Brief at 9. However, Mr. Springer, on cross examination, flatly admitted that Mr. Cristallo "made no reference to City

taxes." CP 416-418; *see also* CP 403, 411, 430. Because the foreign tax dollars at issue were 72 times higher (the foreign tax rates are approximately 30% as compared to the city rate of 0.415%), it is reasonable to infer, as the Director's auditor and witness did, that the tax planning Mr. Cristallo referred to was the foreign tax planning and not local tax planning. CP 416-418.

Fourth, the Director claims that "Getty Seattle confuses the purpose of a cash management system, which everyone agrees is to maximize a business's short term return on cash, with Getty Seattle's subsequent withdrawals from the system's concentration account to pay its expenses." Director's Brief at 5-6. However, witnesses for both parties testified that cash management systems serve two **equal** purposes: 1) to maximize the return on cash; **and** 2) to use the cash where it is needed within the affiliate group. CP 355 ("to have the cash in one central place to effect the payments out"); CP 412-413 ("the companies that need cash has [sic] that cash available to them as needed"); CP 166 (Washington Department of Revenue website); Wash. Dep't of Revenue Final Det. No. 86-309A, 4 WTD 341 (1987) (attached as Appendix E to Brief of Appellant).<sup>1</sup>

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<sup>1</sup> Washington Department of Revenue Determinations (WTD) are published at <http://taxpedia.dor.wa.gov>.

Fifth, the Director asserts that "there is no evidence that Getty Seattle has ever repaid any of those amounts and it is unknown if Getty Seattle will ever do so." Director's Brief at 7. To the contrary, Mr. Dunn testified that "it may well have" already repaid portions of the debt, CP 380-381, and that the debt would remain if Getty Management were sold. CP 358. While there was no repayment schedule, there is always the obligation to repay when called upon to do so. The Director himself admits the existence of such obligation by conceding that "if Getty Management were sold, the sales price received by Getty Seattle would include the value of the accounts receivable." Director's Brief at 23; CP 547-548.

Finally, the Director states that the fact that the cash management transfers are debt is merely an assertion or contention made by Getty Seattle. Director's Brief at 6, 35. This was apparently a calculated way to imply disagreement while not expressly doing so, since extensive testimony in the record establishes that the transfers are debt. CP 356 (if unpaid it is a debt); CP 356 (it is fair to characterize it as a debt or a liability); CP 411 (Director's auditor testifying that accounts payables and accounts receivables both represent debts); CP 357 (intercompany accounts payables and receivables represent debts owed from one affiliate to another); CP 217 (counsel for the Director referring to it as a liability);

CP 424 (Director's auditor testifying "both a note receivable and an account receivable . . . are debts that will eventually be paid off"); CP 387 (both a loan and a payable are debts).

## **II. Summary of Argument**

Getty Seattle does not disagree that it engaged in business in Seattle and owed B&O tax on the consideration it received. Accordingly, Getty Seattle properly reported and paid tax on the \$1 million it received in annual consideration pursuant to the General and Administrative Services Agreement. Getty Seattle, however, disagrees with the Director's imposition of tax on amounts borrowed from affiliate entities.

Furthermore, Getty Seattle does not deny that it did not charge Getty Management fair market value for the administrative services provided. However, there is no statutory or legal requirement that it do so. Therefore, there is no legal means for the Director to impute income, or to recharacterize debt as income, in order to tax Getty Seattle on the value of the services it performed instead of on the consideration or compensation it actually received or accrued.

Similarly, contrary to the Director's contentions, the mere receipt of cash to pay expenses does not qualify such amounts as gross income of the business. Director's Brief at 15, 17. Numerous examples contradict

this ill-conceived rationale, such as gifts, borrowed funds, dividends from a subsidiary, and a capital contribution from a parent.

Because the cash management transfers carry an obligation of repayment, they are patently not gross income of the business, regardless of whether such amounts prove necessary to pay expenses. Contrary to the city's attempts to imply otherwise, these amounts are not artificially designated as borrowed amounts or debt. Respected authority and conventional practices recognize and respect cash management transfers as debt –a fact conceded by the Director's own witness. For these purposes, the terms loan, account payable, note payable, intercompany payable, obligation and debt are synonymous, meaning an obligation to repay (which is inconsistent with consideration).

Finally, Washington courts have refused to apply substance versus form analysis in the tax context in order to deviate from plain statutory language.

### **III. Argument**

#### **A. Under the City Ordinance, Only "Consideration" Received or Entitled to Be Received Is Includable in the Measure of Tax.**

The City Ordinance measures tax only by the consideration actually received or entitled to be received. SMC 5.30.035(D); SMC

5.30.060(F).<sup>2</sup> This is the conclusion reached in the Director's own argument. Director's Brief at 11-15. "In effect, any **compensation** or **gain** received by a taxpayer constitutes gross income under SMC 5.30.035(D)." Director's Brief at 15 (emphasis added). While we prefer to use the word "consideration," we have no particular quarrel with the words "compensation" or "gain." The pertinent question is whether debt proceeds constitute compensation or gain. They do not. "[M]oney management techniques do not result in any actual payments or receipts to the taxpayer." Wash. Dep't of Revenue Final Det. No. 86-309A, 4 WTD 341, 347 (1987) (attached as Appendix E to Brief of Appellant); *Discharge of Indebtedness, Bankruptcy and Insolvency*, 540 Tax Mgmt. Portfolio 3rd (BNA) A-1 (2009) ("The mere borrowing of money does not result in taxable income to the borrower, because the receipt of borrowed money is offset by the obligation to repay."). Cash proceeds obtained by Getty Seattle through Getty's overall cash management system are offset by the obligation to repay and do not constitute compensation or gain.

Given the long-established recognition that cash management transfers are borrowed funds and therefore not subject to Washington's B&O tax, the Director's assessment flies in the face of taxpayers' settled expectations. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 317 (1992)

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<sup>2</sup> The city and the state definitions for "gross income of the business" and "value proceeding or accruing" are identical. RCW 82.04.080; RCW 82.04.090.

(noting the benefits of a clear rule in tax law when such rule "has engendered substantial reliance and has become part of the basic framework of a sizeable industry").

**B. The Director's Court Authorities Are Inapposite.**

In support of its assessment, the Director is attempting to impute income to Getty Seattle or recharacterize debt as income by claiming that such action is supported by the substance over form common law doctrine. The courts have expressly rejected this type of common law remedy, and court authorities relied upon by the Director have no relevance here. In *Engine Rebuilders, Inc. v. State*, 66 Wn.2d 147, 401 P.2d 628 (1965), the court was interpreting the term "gross proceeds of sales," which also incorporates the phrase "value proceeding or accruing." In *Engine Rebuilders*, the taxpayer "receives in exchange a used part." *Id.* at 150. The issue was whether this in-kind consideration constituted "gross proceeds of sales," and the obvious answer was yes. *Id.* at 151. There was little dispute that the taxpayer actually received consideration in that case.

In *Chicago Bridge & Iron Co. v. Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), the issue was whether, under the U.S. Constitution's Due Process Clause and Commerce Clause, the State of Washington could impose its B&O tax on certain construction contracts (i.e., whether the taxpayer and the contracts had sufficient contacts with the state to be

subject to the state's taxing jurisdiction). *Id.* at 816. The case had nothing to do with the proper measure of the tax under state statutes or city ordinances.

In *Ford Motor Co. v. Seattle, Exec. Servs. Dep't*, 160 Wn.2d 32, 156 P.3d 185 (2007), the out-of-state manufacturer of automobiles being sold to local dealers argued that it overpaid city B&O tax imposed by the cities of Seattle and Tacoma for two reasons: (1) its income was taxable under the service classification instead of the wholesaling classification; and (2) even if the wholesale classification applied, the measure of the tax should be reduced to reflect sales activity occurring outside of the city and state. The court, however, held that the wholesale classification applied and that the measure of tax included the proceeds from goods delivered into the cities of Seattle and Tacoma without a reduction to take into account activity occurring outside these cities and the State of Washington. While the court noted that "the substance of each transaction occurs in Washington where the customer is located," this statement was not a rejection of the form of the transactions for B&O tax purposes. *Id.* at 43 (internal quotation marks and citations omitted). The court was simply stating that because the taxpayer's selling activity occurred in the two cities, and that was the defined "taxable incident" of tax under the wholesale classification, then the measure of tax included such proceeds.

Unlike here, there was no dispute as to the amount of "gross income of the business."

Finally, in *Time Oil Co. v. State*, 79 Wn.2d 143, 483 P.2d 628 (1971), the taxpayer acknowledged that when it exchanged petroleum products with a third party, such transactions were subject to B&O tax (much like Engine Rebuilders' receipt of in-kind consideration). *Id.* at 145. The issue was whether Time Oil was also taxable when (1) it requested that an affiliate, U.S. Oil, supply the third party with petroleum, (2) Time Oil was billed by U.S. Oil for supplying such petroleum, and (3) Time Oil billed the third party. *Id.* The court refused to ignore Time Oil's intermediary role and held that the sale by Time Oil to the third party was taxable. The court said to rule otherwise would exalt "form over substance." *Id.* at 147. This unfortunate statement is misleading because, in fact, the court chose to respect and tax both the form and the substance of the transaction. Time Oil billed the third party and was taxed on such consideration, which was the form of the transaction. Thus, rather than supporting the Director's position, *Time Oil* is consistent with the general principle that courts "are guided by the rule that the form of the transaction is usually its substance for purposes of B&O taxation." *United Parking v.*

*Dep't of Revenue*, Board of Tax Appeals No. 42670, 1994 WL 321397 at \*6 (Wash. B.T.A. June 14, 1994).<sup>3</sup>

Similarly, in Getty Seattle's case, the form and its substance are the same. The economic payments to Getty Management are consistent with its contracts, as are the payments from Getty Management to Getty Seattle. Just as U.S. Oil sold petroleum to Time Oil, Getty Seattle sells services to Getty Management. Just as Time Oil turned around and sold the petroleum to the third party, Getty Management sells the same services to its foreign affiliates. Getty Seattle's situation is exactly in line with the court's conclusion in *Time Oil*. Even so, the Director asks this court to disregard the presence of Getty Management in the transactions and collapse the transactions as though Getty Seattle provided the services directly to Getty Management's customers – exactly what Time Oil requested and the court refused to do.

**C. The Director's Reliance on State Department of Revenue Determinations Is Equally Misplaced.**

The Director relies upon three determinations of the Department of Revenue, each of which involve **use tax** rather than **B&O tax**. See Wash. Dep't of Revenue Det. Nos. 90-397, 10 WTD 341 (1990); 94-320ER, 23 WTD 307 (2004); 92-133, 12 WTD 171 (1993). This distinction in the type of tax at issue is relevant because use tax, in contrast to B&O tax, is

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<sup>3</sup> The Board of Tax Appeals' decisions are also published at <http://bta.state.wa.us>.

measured by the "value of the article used." RCW 82.12.020(4). In other words, the use tax measure can be the **market value** when the sales price does not represent the "true value." RCW 82.12.010(7)(a). For purposes of the B&O tax on services, there is no statutory provision for using the market or true value of the service rather than the actual consideration received or accrued.<sup>4</sup>

Additionally, in each determination cited by the Director, the administrative law judges relied upon the federal substance over form doctrine. This is directly contrary to the Director's assertion at the hearing that "we're not relying on federal law." CP 336.

Finally, the cited determinations are contrary to the Department of Revenue's own **B&O tax** determinations. In both Wash. Dep't of Revenue Det. Nos. 87-212, 3 WTD 259 (1987) and Wash. Dep't of Revenue Det. No. 93-303, 14 WTD 054 (1994), the Department of Revenue held that the step transaction subset of the substance over form doctrine did not apply in the context of the B&O tax.

Similarly, in Wash. Dep't of Revenue Det. No. 91-319, 11 WTD 511 (1992), the Department of Revenue expressly refused to impute income to a parent corporation that failed to charge its affiliates for

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<sup>4</sup> Similarly, for manufacturing tax purposes, where the sales price is "not indicative of the true value" the costs may be substituted for the consideration as the measure. SMC 5.45.050(B); SMC 5.30.060(G)(2). Where different words are used in a statute, they are to be construed to mean something different.

administrative services provided. The Department of Revenue explained that in Washington State service B&O tax is imposed only on consideration actually received or accrued, **unlike** the federal tax system which, pursuant to I.R.C. § 482, permits the Internal Revenue Service to impose tax on the value of services when such arrangement is not transacted at arm's length. The Department of Revenue's Determination clearly notes that "there is no management fee charged by the parent to its subsidiary for management services performed for the subsidiary by the parent. . . The only reason for imputing a . . . charge is to 'clearly reflect the income' of related companies . . ." 11 WTD at 512. In ruling in favor of the taxpayer, and refusing to impute income, the Department of Revenue explains that unlike under the federal system, Washington B&O tax has a statutorily prescribed measure, and accordingly, under this set of facts, "No consideration is actually received or accrued by the parent . . . Therefore, since there are no charges, no tax can be imposed on the taxpayer[.]" 11 WTD at 513.

**D. Washington Courts Have Expressly Refused to Apply the Federal Substance Over Form Doctrine and Have Not Adopted Their Own Version Either.**

The substance over form doctrine has been adopted to permit the Internal Revenue Service to tax parties based on the economic substance of a transaction, a subjective conclusion enmeshed in the parties' intent,

motive, and business purpose, as opposed to the clear and evident form of a transaction. However, the doctrine has been rejected by the Washington courts in similar cases.

In *Estep v. King County*, the court was asked to disregard the form of a transaction and impose tax based on the transaction's economic substance. *Estep v. King County*, 66 Wn.2d 76, 401 P.2d 332 (1965). In rejecting the request, the court explained:

Adoption of the rule would write into Washington law a provision not voiced by the legislature . . . It would involve the county and the courts in a search for subjective intents, motives, and purposes . . . Any change in the application of the statutes and ordinance must be legislative.

*Id.* at 80.

The State Department of Revenue has expanded upon *Estep*, stating, "The reasoning stated by the court in *Estep* is equally applicable *to all excise taxes [including B&O].*" Wash. Dep't of Revenue Det. No. 93-303, 14 WTD 054 (1994) (emphasis added).

Likewise, in 1975, the State Attorney General's office opined that "whether 'form' will prevail over 'substance' has been developed primarily in the area of federal income taxation." AGO 1975 No. 6, p. 6. It further observed that Washington's Supreme Court has been reluctant to "enter into the same 'substance versus form' legal thicket in which the federal courts

have become enmeshed." *Id.* at 8. The State Attorney General's office explained that in *Estep*, King County "relied upon a doctrine which is a species of the 'substance over form' doctrine of federal tax law." *Id.* Such inquiry "illustrates the morass in which administrators and courts could well find themselves in an attempt to determine whether 'substance' should prevail over 'form' – the very same morass which led the court in *Estep* to reject 'substance' in favor of 'form.'" *Id.* at 10.

Even if the court here chose to apply the substance over form doctrine, Getty Seattle would prevail because it had a valid purpose for its reorganization (minimization of foreign taxes), not related to the city B&O tax. At the federal level, "to treat a transaction as a sham, the court must find that the taxpayer was motivated by **no** business purposes other than obtaining tax benefits in entering the transaction, **and** that the transaction has no economic substance because no reasonable possibility of a profit exists." *Rice's Toyota World, Inc. v. Comm'r*, 752 F.2d 89, 91 (4th Cir. 1985) (emphasis added and citations omitted).<sup>5</sup> Minimizing the tax of another jurisdiction is a valid business purpose. IRS Rev. Rul. 89-101, 1989-2 CB 67 ("a substantial reduction in the amount of foreign withholding tax imposed on [the company] will benefit the worldwide operations of the affiliated group . . . [and] [t]herefore, the distribution . . .

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<sup>5</sup> The city's new ordinance adopted in 2009 includes a business purpose defense too. SMC 5.45.085(B)(1) (Sec. 9, Ord. 123063).

is carried out for a purpose germane to the business"); IRS Rev. Rul. 76-187, 1976-1 CB 97 (because "[t]he distribution results in a substantial reduction in the amount of state and local taxes paid" the "distribution...was carried out for purposes germane to the business"). Therefore, because the Getty Affiliated Group had a valid business purpose for its reorganization (minimizing foreign taxes), the substance over form doctrine is not applicable.

**E. The Washington Courts' Decisions in *Simpson Investment*, *Weyerhaeuser*, and *Estep* Provide the Necessary Guidance in This Case.**

The cases relied upon by Getty Seattle make clear that Washington's tax laws are driven by the statutory words only, and changes in the law should be made only after consideration by the legislative body, as was done by the city council in 2009 and the Washington State legislature in 2010. Sec. 9, City of Seattle Ord. 123063 (CP 517-521); Laws of 2010, 1st Spec. Sess., ch. 23, § 201.

Both the Court of Appeals and Supreme Court decisions in *Simpson Investment* are on point. In *Simpson Investment*, the State Department of Revenue, like the Director here, argued that Simpson Investment was providing services for affiliates for which it was not being compensated except through the receipt of funds from a cash management system and dividends. Simpson Investment received no income for its

services. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 143-44, 3 P.3d 741 (2000). The case is instructive because the company's cash management system was also challenged by the Department of Revenue. The Department of Revenue argued that the receipt of interest earned on proceeds from the company's cash management system was taxable as compensation for services rather than interest. See Brief of Appellant Getty Seattle at 14-15. The Court of Appeals expressly rejected this argument in footnote 14 of its decision. *Simpson Inv. Co. v. Dep't of Revenue*, 92 Wn.App. 905, 918 n. 14, 965 P.2d 654 (1998) ("Nothing prevents Simpson from avoiding B&O tax by taking its compensation from its subsidiaries in the form of dividends **rather than as explicit payments for services** provided.") (emphasis added) *rev'd*, 141 Wn.2d 139 (2000). It would have been equally true if the subsidiaries received the cash in the form of a bank loan or debt from an affiliate rather than as explicit payments for services provided. The key is that a taxpayer need not take compensation for services if it so desires. "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Estep*, 66 Wn.2d at 77 (quoting *Gregory v. Helvering*, 293 U.S. 465, 469 (1935) (internal quotation marks omitted)).

Furthermore, the Washington Supreme Court, when presented with the same arguments by the Department of Revenue, expressly stated that "[a]ll of Simpson's income comes **from financial sources**," *Simpson Inv.*, 141 Wn.2d at 163 (emphasis added), and there was no "independent source of income" for the services provided. *Id.* at 154. The Supreme Court was directly addressing the argument by the Department of Revenue that it could recharacterize certain cash receipts as fees for services. This conclusion was material to the ultimate holding, and therefore not dicta, because the financial business test was dependent on the character of the taxpayer's income. *Id.* at 155-56.

In addition to *Simpson Inv.*, both *Weyerhaeuser Co. v. State Dep't of Revenue*, 106 Wn.2d 557, 566, 723 P.2d 1141 (1986), and *Estep*, 66 Wn.2d at 80, speak to the Director's lack of power to re-characterize transactions absent a statutory provision.

*Weyerhaeuser* also involves the B&O tax. *Weyerhaeuser* stands for the proposition that Washington tax law, absent specific statutory provisions, does not impute income where none is charged. *See* Wash. Dep't of Revenue Det. No. 91-319, 11 WTD 511, 513 (1992) ("In *Weyerhaeuser Company v. Department of Rev.*, 106 Wn.2d 557, 723 P.2d 1141 (1986), the Washington Supreme Court held that where an installment contract for the sale of timber did not provide for interest, the

Department of Revenue could not impute such interest without statutory or regulatory authority."); Wash. Dep't of Revenue Det. No. 94-272, 15 WTD 78 (1995) ("In [*Weyerhaeuser*], the court held that the state could not impute interest where a timber installment contract did not provide for interest.")

In *Weyerhaeuser*, the State Department of Revenue attempted to impute interest, taxable at a higher rate, on installment sales of timber. The sales were evidenced by a lump sum contract, in which no interest was charged on the unpaid balance. However, under the Securities and Exchange Commission rules and generally accepted accounting principles, *Weyerhaeuser* internally computed and segregated an interest component. 106 Wn.2d at 564.

The Department of Revenue claimed that the substance of the transaction should prevail, arguing: "The Department can recognize *Weyerhaeuser's* imputed interest income figures because these figures reliably represent the true **substance** of the transactions." Brief of Respondent, Dep't of Revenue at 50 (*Weyerhaeuser v. State Dep't of Revenue*, 106 Wn.2d 557) (emphasis added). And further, "[T]he **substance** of the transaction is the imputed interest income figures maintained by *Weyerhaeuser* in accordance with economic realities and standard accounting practices." *Id.* at 53-54 (emphasis added).

The court disagreed, respecting the **form** of the transaction and the **contractual** agreement between the parties: "The controlling statutory language as it now exists simply provides no authority for such imposition. We are guided in this instance by ordinary rules of statutory construction. Any doubts as to the meaning of a statute under which a tax is sought to be imposed will be 'construed against the taxing power.'" *Weyerhaeuser*, 106 Wn.2d at 565-66 (citations omitted).

The court was mindful that its holding left open the opportunity for taxpayers to "attempt to circumvent higher taxation rates by simply refusing to specify interest on their installment contracts." *Id.* at 566. Nevertheless, the court maintained its reasoning that "such circumvention of tax laws may be addressed by statute." *Id.* Accordingly, if the state legislature wished to impute income, it could merely act like Congress in the federal income tax area and adopt controlling statutory language. *Id.* at 566.

Similarly, in *Ban-Mac*, a case preceding *Estep*, the county claimed that the transaction at issue was "purely a mechanical subterfuge" or "tax-saving device employed . . . to avoid payment of the [real estate excise tax]." *Ban-Mac, Inc. v. King County*, 69 Wn.2d 49, 50-51, 496 P.2d 694 (1966). The court reasoned that even if the transaction was structured to avoid the application of the tax, that strategy was "not justification for legislation by the judiciary. . . . We may construe but not legislate in tax

matters." *Id.* at 51. To the extent that the law permits such tax-saving devices, the courts "have a duty to exercise judicial restraint." *Id.*

Furthermore, the courts have routinely noted that "the law does not permit the Department to disregard [two] separate corporate entities and treat them as one entity for tax purposes." *U.S. Tobacco Sales & Mktg. Co. v. State, Dep't of Revenue*, 96 Wn. App. 932, 943, 982 P.2d 652 (1999). Despite this, the Director claims that "the City is not prevented" from taxing Getty Seattle on the income of Getty Management, an entirely separate, out-of-state LLC. Director's Brief at 18. However, in none of the court cases relied upon by the Director have the Washington courts ignored the existence of a separate company. To the contrary, the Board of Tax Appeals has expressly concluded that an entity with "no employees, no payroll, no inventory of goods, no warehouse and no offices" was still taxable on its consideration from affiliates. *Simpson Timber Co. v. Dep't of Revenue*, Board of Tax Appeals No. 30192, 1986 Wash. Tax Lexis 55 (1986).

It cannot be forgotten that "we are guided by the rule that the form of the transaction is usually its substance for purposes of B&O taxation." *United Parking*, 1994 WL 321397. For Washington B&O tax purposes, "form" rather than "substance" is controlling because the essence of the taxable transaction **is form**, and not economic substance. We are dealing

with a statutorily defined **taxable** event, not an economic event." AGLO 1977, No. 6 n. 8 (emphasis in original).

**F. The Washington State Legislature Has Acknowledged that Prior Law Did Not Include Any Substance Over Form Doctrine, and that Income Should Not Be Imputed Between Affiliates.**

The Director raises adoption of SMC 5.45.085 in 2009, arguing that it "establish[es] an explicit procedure for determining the gross income of a taxpayer that engages in transactions with related entities." Director's Brief at 34. The Director correctly observes that SMC 5.30.035(D) does not apply to the audit period at issue. Director's Brief at 35. While there is a serious question whether the city council's action reflects a change in the law (see discussion at CP 504-505), the Washington State Legislature's intent in 2010, on the other hand, is obvious. *See* Laws of 2010, 1st Spec. Sess., ch. 23, § 201. As previously noted, the Washington State Legislature in 2010 considered enactment of statutory provisions relating to tax avoidance. CP 528-530. This reflected an understanding by the legislature that the substance over form doctrine was not applicable in Washington. CP 528-530. The Final Bill Report (2ESSB 6143) explained:

Economic Substance Doctrine. The economic substance doctrine states that a transaction's tax benefits will not be allowed if the transaction does not have economic substance. This common law doctrine is an effort by the courts to enforce legislative intent in situations in which a

literal reading of statutory code would allow a taxpayer to circumvent this intent. The doctrine is used frequently at the federal level to determine whether tax shelters or strategies used to reduce tax liability are considered abusive by the Internal Revenue Service. **Washington courts have not used the economic substance doctrine to interpret tax statutes, but instead have relied on traditional methods of statutory construction . . . .**

(emphasis added).

In considering changes, the legislature consciously considered and rejected the idea of imputing income in situations like the one at hand. An earlier proposed version of the legislation would have allowed the taxing authority to "[i]mpute income to a taxpayer that provides services to a related person [where] the consideration received for providing such services does not reflect fair market value." HB 2970 § 201(1)(e). The version passed by the legislature and signed into law targets arrangements through which a taxpayer attempts to avoid B&O tax on income. Laws of 2010, 1st Spec. Sess., ch. 23, § 201(3)(b). However, it is limited to "avoiding tax on income, from a person that is **not affiliated** with the taxpayer." *Id.* (emphasis added). This was a conscious conclusion that income should continue not to be imputed between affiliates. This legislation is retroactive to January 1, 2006. *Id.* at § 1703.

#### IV. Conclusion

Funds transferred under a cash management system are debt to the receiving affiliate entity. Debt is not consideration to the borrower.

Therefore, borrowed funds under a cash management system are not "gross income of the business" under SMC 5.30.035(D) and are not subject to B&O tax. Furthermore, case law affirmatively rejects the Director's attempt to fashion a common law basis to impose tax in this situation.

For the reasons stated herein, the Superior Court's holding affirming the Hearing Examiner's decision is contrary to the facts and law and should be reversed. Getty Seattle is entitled to a refund of B&O taxes paid on amounts borrowed from affiliates by way of the company's cash management system.

DATED: September 8, 2010 **PERKINS COIE LLP**

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**CERTIFICATE OF SERVICE**

I certify that on this date, I caused a true and correct copy  
of the Reply Brief to be served upon the following via legal  
messenger:

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I further declare under penalty of perjury under the laws of  
the State of Washington that the foregoing is true and correct.

DATED this 8th day of September, 2010.

  
Jessica Flesner

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