

Cite as Det. No. 92-061, 12 WTD 119 (1993).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Determination of)	
Tax Liability of)	No. 92-061
)	
. . .)	Registration No. . . .
)	
)		

[1] REAL ESTATE EXCISE TAX: CORPORATION -- STOCK -- CONSIDERATION. A transfer of real property to a new corporation by parent who is sole shareholder of the corporation's stock is not a taxable sale subject to the real estate excise tax where no additional stock or other thing of value is given in exchange. Subsequent merger of corporation into parent is not a change of ownership and is not subject to real estate excise tax. ACCORD: Det. No. 87-212, 3 WTD 259 (1987); AGO 63-64 No. 44 (1963) (confirmed by AGLO 1977 No. 6); AGO 63-64 No. 86 (1964).

[2] RCW 82.45A: CORPORATE TRANSFER TAX -- Tax does not apply to transfer of real property to corporation by its sole shareholder-parent, because no change in ownership of the corporation occurs. Upon eventual merger into a different corporation which is the parent at the time of the merger, tax does not apply since merger results in survival of one entity and disappearance of the other.

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.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Taxpayer petitions for advance determination of tax liability in contemplated business restructure.

FACTS:

Adler, A.L.J. -- Taxpayer is one of several entities engaging in business in Washington. The purpose of this ruling request is to determine whether a restructure required by lenders will result in a state tax liability. The attorney represents a Massachusetts trust, which will be liquidated in the process of the business reorganization. The parties are referred to by pseudonyms.

A. THE PARTIES AND THE REASON FOR THE PROPOSED TRANSACTIONS:

1. HOT is a trust formed under the laws of Maryland and taxed as a real estate investment trust. It owns 97% of the shares of TRUST.

2. TRUST is a Massachusetts trust formed under the laws of Washington and is also taxed as a real estate investment trust. It owns hotels, including several in Washington.

3. The remaining three percent of TRUST's common shares are privately held, as are two series of TRUST's preference shares.

4. HIC is a Maryland corporation. Its wholly-owned subsidiary, WHI, manages TRUST's properties. HOT and HIC are affiliated. Shares of HOT and HIC are paired and sold as a unit on the New York Stock Exchange.

5. HOT seeks to refinance its debt, which will also result in a restructuring of HOT's and HIC's business operations.

6. HOT's creditors are demanding that title to the real estate be held by HOT as a condition to the agreement to refinance. In that way, clear title to the property belongs directly to the entity borrowing the funds.

a. The most direct way to satisfy the lenders would be to merge TRUST into HOT. As noted in the representatives' application brief to the IRS for a Private Letter Ruling, this is not possible: The trusts are organized under the laws of two different states, and no such merger is authorized by applicable state law.

b. Another direct way would be to terminate TRUST. However, this would require an in-kind distribution of TRUST's assets to its shareholders. Because three percent of the property sought by the lenders as collateral would have to be distributed to the minority shareholders, this path would hinder HOT's ability to grant the lenders a direct security interest in all of the assets.

B. THE PROPOSED TRANSACTIONS:

1. TRUST will redeem all currently-outstanding preference shares. This will result in only common shares being outstanding. The division of ownership will remain the same, with 97% being held by HOT and 3% being privately held.

2. TRUST will form a new Maryland corporation, NEW. Formation of NEW as a Maryland corporation will facilitate the eventual merger of NEW into HOT under Maryland law (Step 8, below).

3. NEW will issue all of its stock to TRUST.

4. Thereafter, TRUST will transfer all of its real estate assets to NEW for no consideration other than the assumption by NEW of the then-existing mortgage and deed-of-trust liabilities thereon.

5. Next, TRUST will transfer all its personal property to NEW for no consideration other than the assumption by NEW of the then-existing liabilities thereon.

6. TRUST will terminate, at which time its only asset will be the stock of NEW.

7. NEW stock will be distributed pro rata to HOT (97%) and the minority shareholders (3%) of TRUST.

8. NEW will merge into HOT.

9. Under Maryland General Corporation law, all shares of NEW will then cease to exist; and the minority shareholders have the right to demand and receive payment from HOT for their stock, which payments HOT will make out of its general funds.

10. HOT will own the real estate and personal property formerly owned by TRUST.

ISSUES:

[1] Does Chapter 82.45 RCW, Real Estate Excise Tax (REET), apply to the transfer of real property either from TRUST to NEW or from NEW to HOT?

[2] Does Chapter 82.45A RCW, enacted in 1991 and subjecting certain ownership transfers of a corporation to excise tax, apply to the transfers of ownership of NEW to TRUST or of NEW to HOT?

DISCUSSION:

[1] REAL ESTATE EXCISE TAX (REET)

REET applies on all sales of real property. RCW 82.45.060. "Sale" is defined as any transfer of ownership in real property for "valuable consideration," which is statutorily defined to include "anything of value." RCW 82.45.010 and RCW 82.45.030. The tax is the seller's obligation under RCW 82.45.080.

A. TRANSFER OF REAL PROPERTY SUBJECT TO LIABILITIES FROM TRUST TO NEW

In this case, the representative explains that TRUST will first create NEW and accept all of NEW's stock. After that transaction is completed, TRUST will transfer all of its real estate. According to the representative, no consideration in any form, including the issuance of additional stock, will occur at the time that the real property is transferred from TRUST to NEW.

If consideration passes in this transaction, the tax clearly applies. RCW 82.45.010; Attorney General Opinions (AGO) 59-60 No. 100 (1960) and 63-64 No. 44 (1963).

As the parties' California counsel explains in the Private Letter Ruling request to the Internal Revenue Service, this is an exchange intended to qualify for federal tax purposes as a "Section 351" exchange of property directly for stock, with no money included in the transaction and with no gain or loss recognized at the time of the transfer. Under this scenario, consideration clearly passes: stock is given in exchange for real property. For the federal tax purpose of avoiding recognition of gain or loss, the parties seek to prove that while consideration was received, it was stock only. Because the realization of the gain or loss has not occurred, recognition in the form of taxability also should not yet occur.

The department has consistently held that parties "may not treat a transaction one way for federal tax purposes and yet another way for state tax purposes." Det. No. 87-354, 4 WTD 293 (1987). The transaction must be analyzed by considering all the facts and circumstances. If consideration passes or elements exist creating an obligation to issue the stock in exchange for the real estate, whether or not the two events occur simultaneously, REET would apply. Minutes from board meetings, plans for reorganization, and other corporate documents authorizing or requiring such a transfer would be examples of such elements.

Conversely, where no consideration is exchanged for the real property, the transaction is exempt from REET. Where the stock of a new company is issued to the creating company prior to the transfer of the real property and where the transfer then occurs

with no consideration being received, real estate excise tax will not apply. Det. No. 87-212, 3 WTD 259, 264-265 (1987); AGO 63-64 No. 44 (1963); AGO 63-64 No. 86 (1964). This is despite the fact that the transaction may, additionally, qualify as an IRC Section 351 exchange. In Det. No. 87-212, 3 WTD at 268, the Department stated:

In Estep, 66 Wn.2d 76, the defendant, King County "assigned error to the court's failure to recognize and consider two instruments as one transaction" The defendants asserted that although the real estate excise tax does not apply to each transaction separately, Deer Park, 46 Wn.2d 852, as one package the transactions should constitute a sale. The Washington State Supreme Court specifically ruled that the Kimbell-Diamond Rule [whereby separate steps taken to accomplish a single objective will be viewed as a single transaction] is inapplicable to the real estate excise tax statute.

In Estep, the court stated:

Adoption of the rule would write into Washington law a provision not voiced by the Legislature and would make suspect every conveyance of real property by a corporate liquidating trustee. It would involve the county and the courts in a search for subjective intents, motives and purposes every time a transfer of stock is followed by a transfer of real property in corporate dissolution. Any change in the application of the statutes and ordinance must be legislative.

(Brackets supplied.)

Here, if the events occur exactly as detailed in the Washington representative's ruling request, the stock of NEW will already be owned by TRUST at the time of the transfer of real property by TRUST to NEW for no consideration. Absent documents, minutes, contracts, or other indicia showing an obligation to transfer the property then or later in exchange for the stock at the time the stock is issued to TRUST, the transaction does not constitute a "sale" for REET purposes.

Additionally, the fact that the property is encumbered does not subject the transaction to REET so long as no consideration passes otherwise. Det. No. 89-534, 8 WTD 433 (1989).

Finally, RCW 82.45.150 states that, with certain enumerated exceptions, the provisions of Chapter 82.32 RCW apply to real estate excise taxable transactions. WAC 458-20-203 (Rule 203) is

adopted pursuant to RCW 82.32.300 and has the same force and effect of law. Rule 203 states that Massachusetts trusts are taxable in the "same way as are separate corporations." Consequently, under WAC 458-61-320(3), this is an exempt transfer between a parent corporation and its wholly-owned subsidiary, and TRUST is not liable for REET.

B. MERGER OF NEW INTO HOT

In this transaction, NEW will merge into HOT; and NEW's stock will be cancelled. Under Maryland law, the transaction is a form of merger available to parent companies owning more than 90% of the subsidiary. Maryland General Corporation Law Section 3-108. That statute grants demand rights to minority shareholders. The representative states the minority shareholders choosing to sell back their stock will receive fair market value from HOT in payment for the shares.

Det. No. 87-212, 3 WTD 259, 266-267 (1987) states REET does not apply to this transaction, because no "sale" occurs pursuant to the holding in Weaver v. King County, 73 Wn.2d 183, 184 (1968). There, the court held that the right of a shareholder to receive assets in kind in a dissolution was the "right following ownership of the stock." In the case of HOT's shares, REET would not apply, because any "transfer" of title was to a parent corporation pursuant to a merger and qualifies for exemption under WAC 458-61-320(1). REET would not apply to redemption of the minority shares following a merger, because no real estate was transferred.

[2] CHAPTER 82.45A RCW, THE OWNERSHIP TRANSFERS TAX

Chapter 82.45A RCW was enacted in 1991, after the legislature decided that all transfers of real property should be subject to the same excise tax burdens. Where the transfer of real property is being accomplished through what the legislature deemed was a transfer of corporate ownership comparable to the sale of the real property, the tax imposed by Chapter 82.45A RCW will apply.

RCW 82.45A.010(1) defines "ownership transfer" as

a transfer or series of transfers in any consecutive twelve-month period for a valuable consideration, of ownership of stock possessing more than fifty percent of the total combined voting power of the issued and outstanding shares of each class of stock entitled to vote.

A. ISSUANCE OF NEW STOCK TO TRUST

A strict reading of the statute would show that the language "in any consecutive twelve-month period" refers to transfers. In this case, if the events occur as planned, there will be no "transfer for a valuable consideration" of stock. NEW will transfer stock for no consideration. TRUST will transfer property for no consideration. As a result, technically RCW 82.45A will not apply. As noted in the section discussing REET on this transaction, we are hesitant to permit such treatment in a transaction the parties blatantly represent to the Internal Revenue Service as an exchange resulting in nonrecognition of gain or loss. However, we believe RCW 82.45A.030(1) would also support exemption from this tax. That section exempts transfers where

the taxpayer demonstrates by a preponderance of the evidence that the primary intent of the ownership transfer is for purposes other than avoidance of the tax imposed in chapter 82.45 RCW.

We believe that such is the case here, when NEW transfers its stock to TRUST. The entities are not seeking to actually sell, dispose of, or discontinue control of the properties. Instead, they are seeking to place title to the properties in the same entity to which lenders will lend funds used to operate the properties. In order to obtain the funds, they are being required by the lenders to undertake this transfer. The difficulties caused by organization of the legal entities, Washington TRUST and Maryland HOT, prevent a direct merger of TRUST into HOT which would accomplish the same result and would not be subject to REET or the corporate transfers tax. The parties are accomplishing the same result through the creation, termination, and merger of the various entities and are managing to do so in a manner which also avoids the taxes. Under the facts as presented, the business purpose for doing so is to obtain financing to continue their ventures, not to transfer properties for consideration while evading tax.

MERGER OF NEW INTO HOT

When NEW and HOT merge, no transfer of corporate ownership occurs. Instead, the wholly-owned subsidiary merges into the parent and the subsidiary disappears.

The merger and consolidation of corporations is governed specifically by statute. Chapter 23A.20 RCW sets forth a procedure by which two or more corporations may combine their assets to become a single surviving entity. A merger or consolidation of corporations under Chapter 23A.20 RCW involves the conversion of the shares of the merging corporations into shares of the surviving corporation or an exchange of shares of

the merging corporation for cash or property. The result of a merger is that the merging corporations are joined, and the survivor is a combined entity. As a result of a merger, the surviving entity possesses all of the rights of each of the merged corporations in their respective assets by operation of law. No transfer of title or ownership of property occurs. The survivor is deemed the owner of all of the assets of the combined entity without further act or deed. RCW 23A.20.060.

Because no transfer of ownership is deemed to occur under the statutes, the corporate transfer tax will not apply in the case of the merger. The tax is intended to apply in cases where, but for the machinations of the parties, REET would apply. Here, REET would rightfully not apply, and the corporate transfer tax also does not apply.

RULING:

On the facts as given by the taxpayer's Washington representative, we find that the proposed transactions are not subject to REET or to the corporate transfers tax imposed by RCW 82.45A, subject to the conditions stated in this Determination.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(9) and is based upon only the facts that were disclosed by the taxpayer. In this regard the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed were actually true. This legal opinion shall bind this taxpayer and the department upon those facts. However, it shall not be binding if there are relevant facts which are in existence but not disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 9th day of March 1992.