

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For For Ruling)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 96-168
)	
...)	Registration No. . . .
)	Real Estate Excise Tax
)	
)	

- [1] RCW 82.45.010: REET -- "SALE" -- HOUSING COOPERATIVE ASSOCIATIONS -- SALE OF STOCK OR CERTIFICATES -- DEFINITION OF "SALE" -- "TRANSFER OF POSSESSION". The phrase in RCW 82.45.010(1) -- "any estate or interest therein or other contract . . . under which possession of the property is given to the purchaser" -- must not be read out of context contrary to the leasehold exemption contained in RCW 82.45.010(3).
- [2] RULE 510(2), RULE 430(2); RCW 82.45.010: REET -- "SALE" -- HOUSING COOPERATIVE ASSOCIATIONS -- SALE OR TRANSFER OF IMPROVEMENTS. The sale of stock in a housing cooperative association that owns the land on which improvements are located is not a taxable "sale or transfer of improvements constructed upon leased land."
- [3] ETB 458: REET -- "SALE" -- HOUSING COOPERATIVE ASSOCIATIONS -- SALE OF STOCK -- COMPARED TO SALE OF CONDOMINIUMS. The sale of stock in a housing cooperative association is not analogous for REET purposes to the sale of a condominium unit.

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:

Request for ruling on the applicability of the real estate excise tax (REET) to the sale of certificates or shares of stock in a cooperative housing association (cooperative).¹

FACTS:

Bauer, A.L.J. -- Taxpayer is an attorney who purchased stock in a cooperative in 1987. At the same time he entered into a lease with that cooperative. He has leased a specific apartment unit from the cooperative ever since, which unit has served as his primary residence. He states that an excise tax was not paid or collected when he purchased shares in the cooperative and that, when he sells his shares, he must know whether an excise tax is payable. He states that this is an issue not only for him, but also for other clients that he represents.

Taxpayer's request for ruling derives from advice given to Taxpayer and title companies by the Special Programs Division of the Department of Revenue (Department) to the effect that sales of stock in cooperatives to persons who are not initial members of the cooperatives are subject to REET.

The Department, in determining these sales taxable, has likened each of them to the

. . . conveyance of a specific parcel of real property even though

[t]he fact that the document involved is a certificate, and not a deed, makes it very unusual. . . . If the document used to convey ownership is a purchase agreement, that is the document that needs to be presented to the county. The certificate itself is not the conveyance instrument.

(Letter from the Department's Special Programs Division to . . . Title Company of 5/5/94, at 1.)

In a subsequent letter directly to Taxpayer, the Department stated additional reasons it considered the sale of cooperative stock to be taxable under the REET:

. . . the "member of the housing cooperative has the right of exclusive occupancy of their leased unit. There is some type of lease agreement which identifies the specific unit. Usually, a new member has purchased the right to occupy the specific unit from the prior owner/member.

This transaction, the transferring the right to occupancy, may take many forms, but is usually some form of a certificate. The right to occupancy may be signified by this certificate, but the actual rights and responsibilities are legally spelled out in the

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

occupancy and lease agreement. Since the arrangement is actually a lease, it should be taxed as a lease.

...

I believe that the transfer of existing housing units falls under WAC 458-61-430, which states in part:

(2) The transfer of a lessee's interest in a leasehold for a valuable consideration is taxable to the extent the transfer includes any improvement constructed on leased land. . . .

(Letter from the Department's Special Programs Division to Taxpayer of 9/1/94, at 1.)

In answer to Taxpayer's further objection to the rationale in the preceding letter, the Department specifically responded:

In your letter you state that the purchaser of the cooperative housing stock does not have any automatic right to occupancy [of] an apartment but this right is granted by separate approval of the landlord, i.e., the association. I must believe that the sales are conditional upon such approval taking place because the buyers are, in fact, buying the right of occupancy of an improvement on leased land.

(Letter from the Department's Special Programs Division to Taxpayer dated 10/31/94, at 1.)

Taxpayer has submitted what he considers the rationale for a better approach. In 1977, at the behest of the Records and Elections Division of King County, the King County Prosecuting Attorney's office wrote to attorneys representing a number of cooperatives.² A meeting was held between King County and the attorneys in which the applicability of the REET to transfers of interests in cooperative apartments was examined in detail. As a result of this meeting, a letter was issued by the King County Prosecutor's office which stated that transfers of personal property, such as stock or membership certificates in cooperatives were not, in and of themselves, taxable under the REET. Taxpayer argues that the analysis in the King County Prosecuting Attorney's office is sound and should be followed.³

²Prior to the enactment of chapter 154 of Washington Laws of 1980, responsibility for the administration of the REET rested with the various counties. The State of Washington, pursuant to this change in the law, began administering the REET on September 1, 1981.

³The analysis contained therein was basically as follows:

If the documents which effectuate a transfer of a cooperative apartment convey an interest in real property, or otherwise identify the transferred interest as a real property interest, the transaction will, of course, be subject to the 1% tax. Also, any transaction which conveys all or substantially all of the rights of real property ownership in a form which is not otherwise exempt from taxation will be deemed a taxable

In support of his request for a ruling, Taxpayer has submitted to this office for review the following documents pertaining to his particular cooperative: Corporate bylaws and amendments, copies of leases between the cooperative and its tenants, copy of shareholder stock certificate, and the house rules.

By way of background, Taxpayer explains that most cooperatives are "duly-formed corporations in good standing." According to Taxpayer, most cooperatives were formed before condominium laws were passed; therefore, no Washington laws specifically covered their formation. Most cooperatives were, and still are, nonprofit corporations which own the real estate and all of the improvements situated thereon. After assets were transferred into these corporations, stock was sold.

Taxpayer has argued that transferees of stock do not always have an automatic right to occupy or lease an apartment.⁴ The occupancy and lease of an apartment are always subject to prior screening and the approval of the landlord (i.e., the cooperative) acting through its board of directors⁵, and the occupancy and lease agreement is between the shareholder, as tenant, and the cooperative.

Taxpayer notes that when shares of stock in a cooperative are sold after the cooperative's initial formation, the buyer pays the seller directly. Rent, on the other hand, is paid to the cooperative itself. Rent is generally somewhat less than fair market value, although it is subject to charges or assessments.

Taxpayer contends that the ownership of stock in a cooperative does not give the owner of the stock any right to mortgage, or to encumber in any way, the real property owned by the corporation. According to Taxpayer, this is so well-established that it, in his experience, is virtually impossible to obtain conventional long-term real estate-type financing because stock purchasers have no ability to give lenders any security interest in the real property owned by the cooperative.⁶

transaction. Conversely, if the right to possession, use and enjoyment of an apartment unit arises under a lease agreement and the individual's rights as a member of the cooperative association are limited to a personal property interest in cooperative stock or membership shares, then no transfer of a taxable real property interest will be deemed to occur upon the sale of stock [and] assignment of lease. In this latter circumstance, the lease agreement must, of course, create a bona fide landlord/tenant relationship between the cooperative association and each member, and vest in the association a reversionary interest in the apartment unit.

⁴We note, however, that the documents submitted by Taxpayer generally provide that the purchase of a share of condominium stock entitles the purchaser to lease a specific apartment unit, and that a shareholder may not indefinitely own a share of stock without leasing the apartment to which it pertains.

⁵Taxpayer states that this is somewhat analogous to a usual commercial or residential lease wherein the landlord specifically provides that a lease cannot be assigned without the landlord's approval.

⁶According to Taxpayer, there is one lender on the east coast, and perhaps another mortgage company in the Seattle area, that will consider giving such financing, but that is an extraordinary exception rather than the rule. Even then,

Cooperatives arrange for repairs/modifications of apartments for its tenants like any landlord. Workmen's liens, if applicable, attach to the property as a whole, and not simply to one defined portion of the structure (i.e., an apartment). This is because, unlike condominiums, there is no definable portion of, or legal description for, real property to follow stock ownership.

In each instance the corporation is the legal owner of the real property and the improvements situated thereon.⁷

ISSUES:

Is the sale of capital stock in a housing cooperative association subject to REET?

DISCUSSION:

In deciding that the sale of stock in a cooperative is a sale subject to REET, the Department first looked to the following provision of the Washington Revenue Act:

As used in this [REET] chapter, the term "sale" shall have its ordinary meaning and shall include any conveyance . . . of the ownership of . . . real property . . . or any estate or interest therein or other contract under which possession of the property is given to the purchaser . . .

(RCW 82.45.010(1); emphasis added).

[1] Although at first blush it may appear that transfers of leasehold interests⁸ are taxable because the RCW 82.45.010(1) definition of "sale" includes "any estate or interest therein or other contract . . . under which possession of the property is given to the purchaser," this phrase must not be read out of context. Taxing the sale of leasehold interests would render the leasehold exemption contained in RCW 82.45.010(3) invalid. This portion of the statute must be read in conjunction with the second half of the sentence, which continues,

financing must be accomplished using pledge agreements secured by the cooperative stock under the Uniform Commercial Code.

⁷Taxpayer has also argued that the mere sale of stock in a housing cooperative association does not in and of itself constitute the transfer or assignment of any leasehold interest in the associations' property, because all leasehold interests in the housing cooperatives are separately negotiated by those associations' board of directors. Taxpayer asserts that a purchase of stock ownership in a housing cooperative does not include a leasehold interest component and must be separately negotiated.

After a review of the corporate bylaws, we do not necessarily agree with Taxpayer's assertions in this respect. However, because our analysis does not rely on these facts, and because RCW 82.45.010(3) exempts the sale of leasehold interests from the REET definition of "sale", Taxpayer's arguments in this respect, and the Department's reliance on an opposite conclusion, are not relevant to our decision.

⁸These leasehold interests are clearly estates in real property, whose sales clearly transfer possession to the purchaser of the leasehold interest.

. . . and title to the property is retained by the vendor as security for the payment of the purchase price.

RCW 82.45.010(1).

This sentence, read in its entirety, merely describes a contract sale where only possession, and not title, immediately transfers to the buyer because title is retained by the seller for security purposes. A further reading of RCW 82.45.010 makes it clear that transfers of leasehold interests are not intended to be taxable:

The term "sale" shall not include:

. . . (b) A transfer of any leasehold interest other than of the type mentioned above [i.e., "any lease with an option to purchase real property, including standing timber..."]

(RCW 82.45.010(3); emphasis added.)

In this case, Taxpayer will likely sell his stock and transfer the lease to his apartment to a pre-approved buyer in accordance with the cooperative's bylaws. The sale of corporate stock will be the sale of personal property, even though the corporation owns the apartment building. The transfer of the leasehold interest will be excluded from the definition of "sale" by RCW 82.45.010(3).⁹

. . .

[2]The Department also concluded that the sale of cooperative stock is taxable under the REET under the portion of RCW 82.45.010(1) that states,

The term [sale] also includes the grant, assignment, quitclaim, sale, or transfer of improvements constructed upon leased land.

and the accompanying regulatory provisions of WAC 458-61-510(2)¹⁰,

⁹ We note, however, that for property tax purposes, the owner of a cooperative share is considered to be the fee owner of his apartment. This is because RCW 84.36.383(1) specifically provides:

As used in RCW 84.36.381 through 84.36.389, except where the context clearly indicates a different meaning:

(1)The term "residence" shall mean a single family dwelling unit The term shall also include a share ownership in a cooperative housing association, corporation, or partnership if the person claiming exemption can establish that his or her share represents the specific unit or portion of such structure in which he or she resides.

The REET, however, has no such legislative provision.

¹⁰Effective March 4, 1994.

The real estate excise tax does not apply to the assignment of the lessee's interest in the leasehold except to the extent that the assignment includes the grant, assignment, quitclaim, sale or transfer of improvements constructed upon leased land. See WAC 458-61-430.

and WAC 458-61-430(2)¹¹,

(2) The transfer of a lessee's interest in a leasehold for a valuable consideration is taxable to the extent the transfer includes any improvement constructed on leased land.

Taxpayer, however, contends that nothing in these provisions applies to the purchase and sale of cooperative stock. Taxpayer points out that the underlying real property itself is not leased, but is owned and continues to be owned, by the cooperative. There has, therefore, been no "grant, assignment, quitclaim, sale, or transfer of improvements constructed on leased land" as the result of the sale of stock in the cooperative.

We agree with Taxpayer that these statutory and rule provisions apply only to the transfer of, by way of sale of a leasehold interest, improvements on leased land. The sale of stock in a cooperative that owns the land on which its improvements are located is not a taxable "sale or transfer of improvements constructed upon leased land. Because the land here at issue is not leased, the provisions of WAC 458-61-430(2) and WAC 458-61-510(2) are inapplicable.

[3] The last question is whether the sale of cooperative stock is taxable under the REET because it is analogous to the sale of a condominium.¹² Condominium sales are analyzed in ETB 458 as follows:

If a residence condominium unit is constructed and sold by a speculative builder, but common usage areas have not been completed, must a builder pay business and occupation tax under the Retailing classification and collect retail sales tax on that part of the sales price attributable to construction of the common usage areas completed subsequent to the sale?

...

Washington law establishes that each residence condominium unit and its undivided interest in the common area is to be considered a single parcel and subject to taxation on that basis. RCW 64.32.190 provides that

Each apartment and its undivided interest in the common areas and facilities shall be deemed a parcel and shall be subject to separate assessments and taxation by each assessing unit for all types of taxes authorized by law including but not limited to special ad valorem taxes and special assessments. . . .

¹¹Effective March 3, 1994.

¹²This issue was independently raised by Taxpayer.

Under Washington law,¹³ the sale of a condominium is a sale, by written deed, of a specific and legally described parcel of real property. Each condominium owner owns not only his own apartment, but also a certain percentage of the common areas, which percentage is shown on the owners' deeds. These deeds are generally treated and recorded as are any other real property deed. A condominium is transferable by deed and can be mortgaged by its owner.

Taxpayer objects to the application of this analysis to isolated sales of cooperative stock by individual owners, correctly arguing that, unlike the sale of a condominium under Washington law, there is no transfer of ownership of any definable portion of the real estate or improvements. There is no provision in Washington law, other than RCW 82.45.010(2) and WAC 458-61-025,¹⁴ to the effect that the sale of stock in a corporation that owns real estate is a transfer of the real estate itself, or of any of its improvements.

Therefore, we hold that the sale of stock in a cooperative is not analogous to the sale of a condominium unit for REET purposes.

DECISION AND DISPOSITION:

Under Washington's current Revenue Code, regulations, and court decisions, Taxpayer's cooperative stock may be sold without the payment of REET for the reasons stated above.

This legal opinion may be relied upon for tax 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 Taxpayer. In this regard, the Department has no obligation to ascertain whether Taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind Taxpayer and the Department upon these facts. However, it shall not be binding if there are relevant facts which are in existence but have not been 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 30th day of September, 1996.

¹³See the Horizontal Property Regimes Act, chapter 64.32 RCW, for condominiums created from its enactment in 1963 until July 1, 1990; and The Condominiums Act, chapter 64.34 RCW, for condominiums created after July 1, 1990.

¹⁴RCW 82.45.010(2) and WAC 458-61-025 provide that the transfer or acquisition of a controlling interest in a corporate entity is taxable under the REET if 50% or more of the stock in the corporation is transferred by persons acting in concert in a one year period. Taxpayer has assured us that this situation is not an issue in this case.