

Cite as Det. No. 14-0133, 33 WTD 594 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) Assessment of))) . . .)))	<u>D E T E R M I N A T I O N</u> No. 14-0133 Registration No. . . .
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[1] WAC 458-61A-101; RCW 82.45.010, RCW 82.45.033: REAL ESTATE EXCISE TAX (REET) – DEFINITION OF “SALE” – “TRANSFER” OR “ACQUISITION” – CONTROLLING INTEREST TRANSFER – EXTINGUISHMENT OF LLC INTEREST. The extinguishment of a member’s fifty percent interest in a limited liability company (LLC) constitutes a transfer or acquisition of a controlling interest in the LLC.

[2] WAC 458-61A-102; RCW 82.45.010, RCW 82.45.030: REAL ESTATE EXCISE TAX (REET) – VALUABLE CONSIDERATION – EXTINGUISHMENT OF LLC INTEREST – RELIEF FROM MAKING CAPITAL CONTRIBUTIONS. The extinguishment of a member’s fifty percent interest in an LLC in exchange for relief from making additional capital contributions to the LLC is a transfer in exchange for a valuable consideration.

[3] WAC 458-61A-202, WAC 458-61A-208, WAC 458-61A-212; RCW 82.45.010: REAL ESTATE EXCISE TAX (REET) – EXEMPTIONS – RIGHT OF SURVIVORSHIP – ASSIGNMENT OF A VENDOR’S INTEREST IN A CONTRACT FOR SALE – ORDER OF SALE BY A COURT IN A FORECLOSURE – QUITCLAIM DEED GIVEN FOR CLEARING TITLE. The transfer of a controlling interest resulting from the extinguishment of a member’s fifty percent interest in an LLC in exchange for relief from making additional contributions to the LLC is not exempt from REET taxation.

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.

Weaver, A.L.J. – A taxpayer petitions for the correction of a real estate excise tax (REET) assessment claiming that the change in ownership in a limited liability company (LLC), which resulted from the extinguishment of a fifty percent owner’s membership interest under the terms of the LLC agreement due to the member’s insolvency, did not constitute a “transfer” or

“acquisition” of a controlling interest in the LLC and that a REET-taxable transaction did not take place. Taxpayer’s petition is denied.¹

ISSUES

1. Whether the change in ownership of an LLC that results from a fifty percent member’s interest being extinguished under the terms of an LLC agreement, due to that member’s insolvency, constitutes a “transfer” or “acquisition” of a controlling interest in the LLC under RCW 82.45.010(2) and WAC 458-61A-101.
2. Whether the change in ownership of an LLC resulting from the extinguishment of a fifty percent member’s interest is exempt from REET because it is analogous to a right of survivorship under RCW 82.45.010(3)(a), an assignment of a vendor’s interest in a contract for sale of real property under RCW 82.45.010(3)(f), an order of sale of a court in a foreclosure proceeding under RCW 82.45.010(3)(i), or a quitclaim deed given for the sole purpose of clearing title under WAC 458-61A-215 .

FINDINGS OF FACT

[Taxpayer] was founded on December 22, 2005, with the purpose of owning and managing rental properties. Taxpayer was formed by two original members, [Member #1] and [Member #2]. As a part of Taxpayer’s formation, the members executed a Certificate of Formation and Limited Liability Agreement. Appendix A of that Agreement states that Member #1 and Member #2 each owned a fifty percent interest in Taxpayer upon formation.

After formation, Taxpayer acquired two parcels of property, one at . . . , Washington (Property #1) and the other at . . . , Washington (Property #2). Member #1 transferred Property #1 to Taxpayer at or near the date of Taxpayer’s formation. Taxpayer acquired Property #2 by Deed of Trust on or about April 13, 2007.

In 2011, Taxpayer was in need of operating capital from its members to continue operating its rental properties. At that time, Member #2 was insolvent and unable to contribute money to keep Taxpayer operational. Member #2 informed Member #1 that it could not pay its share of the additional funds required to keep Taxpayer operational.

The Limited Liability Agreement provides, in relevant part, as follows:

- e. Disassociation of a Member. A Member of the Company shall cease to be a member of the Company upon the occurrence of any of the following events:

. . . .

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

- (4) Unless all remaining Members consent at the time, occurrence of any of the following events: **bankruptcy, insolvency**, general assignment for the benefit of creditors, dissolution, or legal incompetency of a Member.

Limited Liability Agreement, ¶ 7(e)(4) (emphasis added).

On August 23, 2011, at a Special Meeting, the Members agreed that Member #2 would be disassociated from Taxpayer and its membership was revoked and terminated as of that date. The Minutes of that Special Meeting read, in pertinent part, as follows:

The LLC is in need of operating capital and [Member #2] is unable to provide additional operating capital in a proportional amount to his Membership Interest

. . . .

Therefore, in light of [Member #2]’s failure to contribute additional capital and in light of the fact that [Member #2] has informed the other Member that he is insolvent, [Member #2] is hereby disassociated from the LLC and [Member #2]’s Membership is hereby revoked and terminated effective immediately.

Special Meeting Minutes, dated August 23, 2011. On August 23, 2011, Member #2’s membership interest was extinguished and Member #1 became the sole Member of Taxpayer.

On March 18, 2013, the Special Programs Division of the Department of Revenue issued a REET assessment for tax due as a result of the controlling interest transfer of the two parcels of property owned by Taxpayer. The Special Programs Division calculated tax on the county-assessed value of the properties, which totaled \$. . . . The Special Programs Division assessed \$. . . in REET. Taxpayer filed a timely appeal.

ANALYSIS

REET is imposed upon the sale of real property in Washington. RCW 82.45.060. RCW 82.45.010 defines “sale” to include: “[A]ny conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property . . . for a valuable consideration.” RCW 82.45.010(1).

The term “sale” also includes “the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration.” RCW 82.45.010(2). RCW 82.45.033(1)(b) defines the term “controlling interest” in relevant part to mean: “In the case of a partnership, association, trust, or other entity, fifty percent or more of the capital, profits, or beneficial interest in such partnership, association, trust, or other entity.” RCW 82.45.033(1)(b); *see also* WAC 458-61A-101(2)(a)(ii). Stated succinctly, in Det. No. 97-240R, 21 WTD 145 (2002):

There are two prerequisites for imposition of the tax: (1) the transfer of an interest in real property or controlling interest in a realty-holding entity; and (2) consideration paid or contracted to be paid in exchange for the transfer. *State ex rel Namer, Inc. v. Williams*, 73 Wn.2d 1, 435 P.2d 975 (1968).

21 WTD at 147. There is no dispute in this case that Member #2 owned a fifty percent interest in Taxpayer, prior to the extinguishment of its interest. Nor is there a dispute that Member #1 became the sole owner of Taxpayer after Member #2's interest was extinguished.

Taxpayer's argument is that the extinguishment of Member #2's interest in the LLC through the operation of the disassociation and insolvency provisions of the Limited Liability Company Agreement did not constitute a "transfer" or "acquisition" of a controlling interest. Taxpayer likens the transaction here to several REET-exempt transactions, including the REET exemption for transfers that result from the operation of a joint tenancy with right of survivorship, the REET exemption for judicial and non-judicial foreclosures, and the REET exemption for clearing or exiting title.

The initial question posed in this appeal is whether the transaction at issue in this case constitutes the "acquisition" or "transfer" of a controlling interest. The terms "acquisition" and "transfer" are not specifically defined in the REET statutes. "In the absence of a specific statutory definition, words in a statute are given their common law or ordinary meaning." *In re Estate of Stover*, 178 Wn. App. 550, 315 P.2d 579 (2013) (quoting *State v. Chester*, 133 Wn.2d 15, 940 P.2d 1374 (1997)). Courts may use a dictionary definition to determine the plain and ordinary meaning of terms when they are not defined in the statute. *State v. Watson*, 146 Wn.2d 947, 956, 51 P.3d 66 (2002).

In the real estate context, the Court of Appeals has held that the common law definition of "acquisition" is "the gaining of possession or control over something." *See City of Seattle v. McCoy*, 112 Wn. App. 26, 31, 48 P.3d 993, 996 (2002) (quoting Black's Law Dictionary 24 (7th ed. 1999)). This is in accord with the dictionary definition of "acquire," which reads, in relevant part: "1 : to come into possession, control, or power of disposal of" WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 18 (3rd ed. 1993). The dictionary definition of "transfer" reads, in relevant part: "1 c : to cause to pass from one person or thing to another" WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2427 (3rd ed. 1993). In this case, Member #1 owned a fifty percent interest in Taxpayer, prior to August 23, 2011, when the Members agreed to disassociate Member #2 under the terms of the Limited Liability Agreement. After Member #2 was disassociated and its interest extinguished, Member #1 gained an additional fifty percent interest in Taxpayer and became Taxpayer's sole member and owner.

. . . We hold that under the plain language of RCW 82.45.010(2), the extinguishment of Member #2's fifty percent interest in Taxpayer constituted the transfer or acquisition of a controlling interest in Taxpayer by Member #1.

Having decided that the extinguishment constituted the transfer or acquisition of a controlling interest in Taxpayer, we must next address whether the transfer or acquisition was for a "valuable consideration." WAC 458-61A-102(2) defines "consideration" to include:

[M]oney or anything of value, either tangible or intangible, paid or delivered, or contracted to be paid or delivered, including performance of services, in return for the transfer of real property

WAC 458-61A-102(2); *see also* RCW 82.45.030(3). In this case, Taxpayer was in need of capital contributions from its members to continue operating its rental business. Member #2 was insolvent and was, therefore, unable to make any capital contributions to Taxpayer. Indeed, the Special Meeting Minutes specifically identified Member #2's inability to provide additional operating capital as the reason for the disassociation and the termination of Member #2's membership in Taxpayer. In other words, in lieu of making the capital contributions it was unable to make financially, Member #2 elected instead to disassociate from Taxpayer and extinguish its membership interest. We hold that the relief Member #2 received from the need to contribute additional capital to Taxpayer constitutes a valuable consideration.

Having ruled that the transfer or acquisition of a controlling interest was for a valuable consideration, we turn to Taxpayer's additional arguments that the transfer or acquisition is exempt from REET. When a rule and statute purport to provide a benefit to a taxpayer by allowing a sale without the payment of REET, the tax benefit or exemption must be narrowly construed. *See* Det. No. 97-180, 17 WTD 81 (1998) (citing *Budget Rent-A-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 1972)). We note, initially, that Taxpayer does not cite a specific REET exemption for the extinguishment of a membership interest under a limited liability agreement. Instead, Taxpayer argues by analogy to other REET exemptions.

Taxpayer first argues that the extinguishment of Member #2's fifty percent interest in favor of Member #1 is analogous to the right of survivorship that occurs upon the death of a joint tenant. RCW 82.45.010 states that, for REET purposes, the term "sale" does not include "[a] transfer by gift, devise, or inheritance." RCW 82.45.010(3)(a). WAC 458-61A-202 specifies that: "(5) [t]he transfer of real property to a surviving spouse or surviving domestic partner in accordance with a community property agreement or a survivorship clause is not subject to real estate excise tax." The extinguishment of Member #2's fifty percent interest is not in the nature of a "gift, devise, or inheritance," nor is it in any way similar to a right of survivorship that is triggered by the death of a natural person. *See* RCW 11.18.200(2)(b). Given that tax benefits and exemptions are to be narrowly construed, Taxpayer's reliance on the REET exemption for joint tenancy with right of survivorship is misplaced. The exemption for joint tenancy with right of survivorship does not apply to the transfer at issue in this case.

Taxpayer next argues that when a vendor's interest in a contract for the sale of real property is assigned or transferred, REET does not apply. *See* RCW 82.45.010(3)(f). Similarly, Taxpayer cites RCW 82.45.010(3)(i) and WAC 458-61A-208, which state that REET does not apply to any transfer or conveyance made pursuant to an order of sale by a court in any mortgage or lien foreclosure proceeding. However, again, these examples are not applicable to the matter at hand. Neither Taxpayer nor its members were vendors in a contract for the sale of real property. Likewise, the transfer at issue was not made pursuant to an order of sale by a court in a mortgage or lien foreclosure proceeding. For these reasons, Taxpayer is not eligible for a REET exemption under these cited authorities.

Finally, Taxpayer cites WAC 458-61A-215, which states that REET does not apply to quitclaim deeds given for the sole purpose of clearing title if no consideration passes otherwise. Taxpayer claims that the extinguishment of Member #2's interest was done to merely exit title. However, the transfer in this case was not effectuated by quitclaim deed. Moreover, we disagree that the extinguishment of Member #2's interest merely cleared title to the properties owned by Taxpayer. Prior to Member #2's interest being extinguished, Member #1 had only a fifty percent interest in Taxpayer and, therefore, had only a fifty percent beneficial interest in the properties owned by Taxpayer. After Member #2's interest was extinguished, Member #1 was the sole owner of Taxpayer and the beneficial interest in the subject properties was his and his alone. This transaction at issue in this case was not done for the purpose of clearing title, so the provisions of WAC 458-61A-215 are inapplicable.

In conclusion, while there is no specific provision in the statutes or rules that specifically addresses the facts in this case, we find the following example in WAC 458-61A-101(2)(a)(ii)(C) to be instructive:

- (C) Anne, Bobby, Chelsea, and David each own 25% of the voting shares of a corporation. The corporation redeems the shares of Bobby, Chelsea, and David. Anne now owns all the outstanding shares of the corporation. A taxable transfer occurred when the corporation redeemed the shares of Bobby, Chelsea, and David.

WAC 458-61A-101(2)(a)(ii)(C). While this example deals with the redemption of corporate shares, rather than the extinguishment of an LLC membership interest, we find the principle of the example to be applicable. In this case, like in the example above, the beneficial interests of an entity were adjusted so that one person acquired a controlling interest in the entity and became the sole beneficial owner of the real property owned by the entity. In both situations, a taxable transaction has occurred.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 18th day of April, 2014.