

Cite as Det. No. 00-121, 21 WTD 281 (2002)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 00-121
)	
...)	Registration No. . . .
)	Audit No. . . .
)	
)	

- [1] WAC 458-61-025; RCW 82.45.010: REET – STOCK TRANSFER. Where 100% of the stock of a company that owns 100% of a company that owns Washington real property is sold, REET applies to the transaction.
- [2] RCW 82.45.060: REET – STOCK TRANSFER – OUT-OF-STATE – NEXUS. Where controlling interest of a corporation that owns a corporation that owns Washington real estate is sold in a transaction negotiated and consummated entirely without Washington, REET still applies to the transaction.
- [3] WAC 458-61-025, WAC 458-61-030: REET – STOCK TRANSFER – CONSTITUTIONALITY -- EQUAL PROTECTION. Provision for the same primary and alternative means for establishing the measure of REET are in place in the applicable regulations for both stock and deed transactions. The law imposing REET in the case of the transfer of controlling interest in a corporation or other entity, therefore, does not violate Constitutional equal protection provisions.
- [4] WAC 458-61-025, WAC 458-61-030: REET – MEASURE OF – PROPERTY TAX ROLLS – FACTORY – FIXTURES. When the measure of REET is properly set by resort to the property tax rolls, the characterization by the county assessor of factory machinery and equipment as real property fixtures will not be disturbed for the purpose of setting the measure of REET.

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:

Appeal of real estate excise tax (REET) triggered by the sale of a corporation.¹

FACTS:

Dressel, A.L.J. -- . . . (taxpayer) purchased all of the stock of . . . [Corporation] in March, 1998. Prior to the purchase, [Corporation] was owned by a number of investors, including majority shareholder . . . [Investment Firm], [an out-of-state] private investment firm. The taxpayer's purchase of this stock was negotiated [outside Washington]. At the time of its acquisition by the taxpayer, [Corporation] had four wholly-owned subsidiaries. Among them was . . . [Subsidiary]. [Subsidiary] owned a large parcel of developed Washington real estate, On this property [Subsidiary] operated a . . . (factory).

Sometime after the completion of this transaction, the Department of Revenue (Department) learned that the taxpayer had changed its name, slightly, but that it, otherwise, was the same company conducting the same business with the same Department registration number. After investigation the Department concluded that REET was due on the transaction, measured by the true and fair value of [Subsidiary]'s real property located in Washington. The Department cited RCW 82.45.010(2), which includes in the definition of "sale" the transfer of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration. It then proceeded to assess \$. . . in tax, interest, and penalties against the taxpayer under Audit No.

The taxpayer has appealed the assessment. It argues that the taxpayer, as the purchaser of [Corporation], not [Subsidiary] directly, is too remote in the chain of corporate ownership for the tax to be imposed. While it, effectively, concedes that [Subsidiary] would owe REET if it sold the factory, and that, even, [Corporation] might owe REET if it sold its interest in [Subsidiary], the taxpayer contends its purchase of [Corporation] is an act too remote from the realty in question to create a tax liability for the taxpayer.

Secondly, the taxpayer argues that Washington does not have nexus to impose REET in this circumstance. It states that the sale of the [Corporation] stock was negotiated and consummated entirely outside of Washington. It adds that [Corporation] did not own any real property in this state. Consequently, the taxpayer concludes, there is no nexus between the stock sale and this state.

Thirdly, it contends that application of the corporate transfer provision of the REET law denies the taxpayer equal protection of the laws and is, thus, invalid. It suggests that the measure of REET is computed differently in the case of a stock transfer than it is in the case of a transfer by deed. Because these two transfers are in the same class, it states each class must be treated similarly, but each class is not treated similarly because of differing formulae for determining the measure of REET.

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

Lastly, the taxpayer objects to the measure of the tax on the basis that it was calculated using the county assessor's valuation of the factory and grounds, which valuation included substantial factory equipment, which, the taxpayer says, should have been categorized as personalty rather than as real property fixtures.

ISSUES:

1. When a company has an ownership interest in Washington real property and is a wholly-owned subsidiary of a parent company, is REET due on the sale of the parent company when the stock purchase of the parent is wholly consummated outside Washington?
2. In the above stock purchase is there nexus between the acquiring company and the state of Washington?
3. Does the REET violate the equal protection clause of the Constitution because it calls for a different measure in the case of a transfer of corporate stock?
4. Did the Department, erroneously, consider \$. . . million worth of machinery and equipment as real property fixtures?

DISCUSSION:

Both transfers of real property by deed and transfers of real property through the mechanism of selling the stock of a corporation that owns real estate are subject to the real estate excise tax (REET). The particular provision of the law that makes stock transfers subject to the tax is RCW 82.45.010(2). Its first sentence reads, "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." "Sales" of real property are, actually, subjected to REET in RCW 82.45.060. The Department has adopted an administrative rule that explains the application of the REET statutes in a stock transfer situation.

In its explanation of the applicability of REET by virtue of a stock transfer, WAC 458-61-025 provides some sample transactions. Subsection (2)(b)(vii) of this regulation reads:

(vii) Example 5. Corporation XRAY has 2 stockholders, A and B. A owns 90 shares of stock (90%) and B owns 10 shares of stock (10%). XRAY owns 60% of the stock of Corporation YANKEE, which owns real property. A, by virtue of owning 90% of the XRAY's stock, has a 54% interest in YANKEE (90% interest in XRAY multiplied by the 60% interest XRAY has in YANKEE equals the 54% interest A has in YANKEE). A sells his 90 shares of stock in XRAY to B. A, by selling his 90 shares of XRAY stock, has transferred a controlling interest (54%) in an entity that owns real property (YANKEE). This transfer is subject to the real estate excise tax. The real estate excise tax due is computed on the true and fair value of the real property owned by YANKEE.

[1] In the case before us, 100% of the stock in [Corporation] has been sold by [Investment Firm] and others to the taxpayer. Like XRAY owns a majority interest in YANKEE which owns real estate, [Corporation] owns a majority interest² in [Subsidiary] which owns real estate. To be more precise about the ownership interests, let us convert the instant situation into the same terms as those given in the example. In this case we have a number of shareholders, including [Investment Firm] as a majority stockholder of [Corporation], selling 100% of the stock in [Corporation] to the taxpayer. [Corporation] owned 100% of [Subsidiary]'s stock. Thus, consistent with the example, [Investment Firm] and the other shareholders also had a 100% interest in [Subsidiary] (100% interest in [Corporation] multiplied by the 100% interest [Corporation] has in [Subsidiary] equals the 100% interest [Investment Firm] and the other shareholders have in [Subsidiary]).

“Controlling interest” is defined at RCW 82.45.033 as: “In the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of the corporation entitled to vote, or fifty percent of the capital, profits, or beneficial interest in the voting stock of the corporation” Thus, as in the example in WAC 458-61-025, a controlling interest in a corporation, [Subsidiary], that owns real property in Washington, has been transferred. REET was, therefore, properly assessed.

On the first issue, the taxpayer’s petition is denied.

Second of the issues is whether there is nexus between the acquiring company and the state of Washington. In *Det. No. 96-6*, 16 WTD 61 (1996), another taxpayer challenged the REET in a similar stock transfer that was consummated entirely outside the state of Washington. In answering that challenge, we addressed, among other factors, the question of nexus. In the cited case the taxpayer contended that the Commerce Clause of the United States Constitution prohibits the imposition of REET when the sale and transfer of stock occurs outside the state of Washington. We said:

The Commerce Clause, United States Constitution Art. I, § 8, Cl. 3, affirmatively grants to the federal government the power to regulate commerce "among the several States." In general, a four-part test for sustaining a tax against a Commerce Clause challenge applies, to wit:

the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

² As mentioned previously, [Corporation]'s majority interest is, actually, total interest or 100%.

[3] In order to come within the ambit of the Commerce Clause, the taxpayer characterizes the tax as one on the sale of securities, which are subject to commerce among several states. The problem with this characterization is that the tax bears no relation to the funds received for the shares or the number of shares sold. Rather, the incident giving rise to the tax is the transfer of the beneficial ownership in real property located in this state and the amount of the tax is based on the value of that property. In this context, the transfer of shares outside this state is the equivalent of a transfer of a deed outside this state. In either instance, the incident giving rise to the tax remains the same.

In general, an interest in land can be transferred only in accordance with the laws of the state where the land is located. Donaldson v. Greenwood, 40 Wn.2d 238, 251, 242 P.2d 1038 (1952). Whether by deed or sale of a controlling interest, it is the transfer of the ownership of real property located in this state that gives rise to the tax. Such transfers are purely local in nature and are not the proper subject of a Complete Auto type of analysis. See Mahler v. Tremper, 40 Wn.2d 405, 243 P.2d 627 (1952). In concluding that real estate excise taxes imposed by the counties did not violate constitutional provisions relative to taxes on property, the Mahler court stated:

a tax upon the sale of property is not a tax upon the subject matter of that sale. A sales tax upon personal property or a sales tax upon real property is a tax upon the act or incidence of transfer. The imposition relates to an exercise of one of several rights in and to property. Imposition is not upon each and every owner merely because he is the owner of the property involved.

In this case, the legislature has elected to impose a real estate transfer tax when a controlling interest in an entity that owns real property in this state is sold. The imposition relates to the exercise of a right in and to property, as defined by the legislature, and not to the sale of the shares of stock.

[2] As in the quoted case, the real property transferred is located in the state of Washington. For the same reasons, Washington may impose its REET on the instant transfer regardless of where the documents perfecting that transfer were signed. Taxpayers may not escape liability for the transfer of Washington property by signing documents outside the state or by negotiating said transfer outside the state, whether it be by deed or by the sale of a controlling interest in a corporation. Nexus is established by the taxpayer's ownership interest in the subject Washington real estate.

On the second issue, nexus, the taxpayer's petition is denied.

Third of the issues is whether REET violates the "equal protection clause" of the Constitution, because a different measure of tax may be imposed in the case of a stock transfer as opposed to a transfer by deed. According to the statute, the measure of REET is the selling price, and the selling price means the true and fair value of the property conveyed. RCW 82.45.030 states:

(1) As used in this chapter, the term "selling price" means the true and fair value of the property conveyed. If property has been conveyed in an arm's length transaction between unrelated persons for a valuable consideration, a rebuttable presumption exists that the selling price is equal to the total consideration paid or contracted to be paid to the transferor, or to another for the transferor's benefit.

(2) If the sale is a transfer of a controlling interest in an entity with an interest in real property located in this state, the selling price shall be the true and fair value of the real property owned by the entity and located in this state. If the true and fair value of the real property located in this state cannot reasonably be determined, the selling price shall be determined according to subsection (4) of this section.

(3) As used in this section, "total consideration paid or contracted to be paid" includes money or anything of value, paid or delivered or contracted to be paid or delivered in return for the sale, and shall include the amount of any lien, mortgage, contract indebtedness, or other incumbrance, either given to secure the purchase price, or any part thereof, or remaining unpaid on such property at the time of sale.

Total consideration shall not include the amount of any outstanding lien or incumbrance in favor of the United States, the state, or a municipal corporation for taxes, special benefits, or improvements.

(4) If the total consideration for the sale cannot be ascertained or the true and fair value of the property to be valued at the time of the sale cannot reasonably be determined, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price.

"Selling price" is also defined/explained in the "definitions" rule of Chapter 458-61 WAC. These definitions are meant to apply to REET, generally, whether the transfer of real property is by a deed or a transfer of stock. WAC 458-61-030(10) reads:

(10) "Selling price" means the true and fair value of the property conveyed. A rebuttable presumption exists that the true and fair value is equal to the total consideration paid or contracted to be paid to the transferor or to another for the transferor's benefit.

(a) When the price paid does not accurately reflect the true and fair value of the property, one of the following methods may be used to determine the true and fair value:

(i) A fair market value appraisal of the property; or

(ii) An allocation of assets by the seller and the buyer made pursuant to section 1060 of the Internal Revenue Code of 1986, as amended.

(b) When the true and fair value of the property to be valued at the time of the sale cannot reasonably be determined by either of the methods in (a) of this subsection, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price. (RCW 82.45.030)

WAC 458-61-025 relates, in particular, to REET imposed by the transfer of a controlling interest in a corporation or other entity. Numbered paragraph four of this regulation states:

(4) **Measure of the tax.** The measure of the tax is the selling price of the real property in this state owned by the entity whose controlling interest has been acquired. See WAC 458-61-030(10) for a definition of selling price.

(a) If the price paid does not accurately reflect the true and fair value of the property, one of the following methods may be used to determine the true and fair value:

(i) A fair market value appraisal of the property; or

(ii) An allocation of assets by the seller and the buyer made pursuant to section 1060 of the Internal Revenue Code of 1986, as amended.

(b) If the true and fair value of the property to be valued at the time of the sale cannot reasonably be determined by either of the methods in (a) of this subsection, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price.

[3] As is readily apparent from a reading of these quoted rule sections, they are nearly identical and both measure the tax by the true and fair value of the property conveyed. Therefore, in the determination of the measure of REET, there is no difference between the two sections. While we concede that the selling price of stock may not equal the true and fair value of the real property very frequently, so that the alternative provisions are brought into play more often, we do not find that these provisions deny a stock-transferring taxpayer equal protection. In some cases the value of the stock may equal the true and fair value of the property.³ In the others the same alternative provisions are used for setting the “true and fair value” in stock transactions as are used in deed transactions. As a consequence, we conclude there is no denial of equal protection.

On the third issue, equal protection, the taxpayer’s petition is denied.

Lastly, we will examine the characterization of machinery and equipment at the factory as real property. As stated above:

(a) When the price paid does not accurately reflect the true and fair value of the property, one of the following methods may be used to determine the true and fair value:

(i) A fair market value appraisal of the property; or

(ii) An allocation of assets by the seller and the buyer made pursuant to section 1060 of the Internal Revenue Code of 1986, as amended.

(b) When the true and fair value of the property to be valued at the time of the sale cannot reasonably be determined by either of the methods in (a) of this subsection, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price. (RCW 82.45.030)

³ The value of the stock might equal the true and fair value of the property where the seller and/or buyer have the property appraised and structure their stock transaction such that the price of the stock coincides with the appraised value. It is to be noted, though, that, formally, the statutorily-mandated measure of REET in a stock transfer transaction is the true and fair value of the real property, not the value of the stock, which, may or may not, equal the true and fair value of the real property.

[4] WAC 458-61-030(10). *See also* WAC 458-61-025(4). The parties, apparently, agree that the price paid for the stock does not reflect the true and fair value of the real property. The Department has used alternative means to compute true and fair value. The taxpayer has not suggested that the price paid for the stock equates to the true and fair value of the [Subsidiary] real property. Neither has the taxpayer proposed any other method for determining the measure of REET, such as a “fair market appraisal” or an “allocation of assets” pursuant to section 1060 of the Internal Revenue Code.⁴ The Department has, thus, properly relied on WAC 458-61-030(10)(b)⁵, which is entirely consistent with the cited statutes and regulations.

Rather than availing itself of the opportunity to measure the tax by an alternative means of establishing the true and fair value, i.e. an appraisal, the taxpayer has challenged the county assessor’s valuation of the property. The assessor’s valuation, necessarily, contains a characterization of property as real or personal. The assessor’s valuation is its valuation for all purposes, and we will not disturb the assessor’s valuation by adjustments to that characterization. For our purpose, which is to determine the validity and amount of the REET, the Department acted in accordance with the applicable regulations. As an alternative in setting the measure of REET, “the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price”. *Id.* That is what the Department used.

On the fourth issue, machinery and equipment, the taxpayer petition is denied.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 23rd day of June 2000.

⁴ See WAC 458-61-030(10).

⁵ Or WAC 458-61-025(4).