Cite as Det. No. 96-006, 16 WTD 61 (1996)

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

In the Matter of the Petition For Correction of Assessment of . . .	)))))))	D E T E R M I N A T I O N No. 96-006 Real Estate Excise Tax Refund Request

WAC Ch. 458-62; RCW Ch. 82.45: REAL ESTATE EXCISE TAX -- TRANSFER OF CONTROLLING INTEREST -- PROPORTIONATE SHARE. Real Estate Excise Tax (REET) is imposed on 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. Each seller acting in concert is liable for its proportionate share of REET based on the value of the property on the date of sale. An Employee Stock Ownership Plan (ESOP) selling its interest in a corporation at the same time the employer sells its interest in the corporation is acting in concert and each is liable for its proportionate share of REET at the time of sale.

1. 29 U.S.C. § 1144(b): B&O TAX -- ERISA PREEMPTION OF STATE LAW. The Employee Retirement Income Savings Act of 1974 (ERISA), 29 U.S.C. § 1001, et seq., preempts state tax laws that "relate to" employee benefit plans. However, state tax laws that operate in a tenuous, remote, or peripheral manner do not warrant a finding that the state law relates to the plan. In general, a transactional tax of general application such as REET is simply a cost of doing business and does not relate to a plan other than in a tenuous, remote, or peripheral manner. This state's REET provisions, in and of themselves, are not preempted as they apply to real estate transfers by an ESOP.

1. WAC Ch. 458-62; RCW Ch. 82.45: United States Constitution, Art. I, § 8, Cl. 3: REAL ESTATE EXCISE TAX -- TRANSFERS OF CONTROLLING INTEREST -- COMMERCE CLAUSE CHALLENGE. The legislature has defined the sale of real property to include the transfer of the controlling interest in an entity that owns real property in this state. In such cases, the incident giving rise to the imposition of REET is the transfer of the beneficial ownership in real property located in this state. The taxation of such transfers is solely a matter of state law, even though the transfer of the shares of stock occurred outside this state.

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.

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NATURE OF ACTION:

An Employee Stock Ownership Plan (ESOP) protests the imposition of real estate excise tax (REET) following the sale of all of the employer stock that it held. This sale, alone or in combination with the sale of the employer's stock, resulted in a transfer of controlling interests in several entities that owned real property in this state.[1]

FACTS:

Mahan, A.L.J. -- The taxpayer is a tax-qualified defined contribution plan of deferred compensation under section 401(a) of the Internal Revenue Code (IRC) of 1986, as amended. The taxpayer provides deferred compensation for the employees of four related entities, each of which owned real property in this state. In accordance with the laws and regulations controlling such qualified plans, the taxpayer invests primarily in employer securities.

On September 14, 1994, the taxpayer requested a ruling from the Department of Revenue's (Department) Taxpayer Information and Education Division to the effect that the imposition of REET following the transfer of its shares of stock was preempted by the Employee Retirement Income Security Act of 1974 (ERISA). On October 6, 1994, without directly addressing the issue of preemption, Tax Policy Counsel for the Department ruled that the applicable REET provisions were saved from preemption because they regulate "insurance, banking, or securities", citing 29 U.S.C. § 1144(b)(2)(A). The taxpayer timely appealed that ruling.

On November 7, 1994, all of the shares of stock or interests in the four related entities were sold to a third-party. A Real Estate Excise Tax Affidavit/Return was filed for each of the entities. These returns were used to report the transfer of controlling interest in the entities that owned real property in this state. These affidavits identified each individual entity as the transferor of the real property that it owned. Upon the request of the taxpayer, the Department's Special Programs Division changed the returns to identify the taxpayer as the transferor in all four transactions. There was no change in the authorized agent signing on behalf of the transferors.

Using the assessed value of the properties, the related entities and/or the taxpayer reported the transfer of real properties. The taxpayer and/or the entities that owned the properties paid local and state real estate excise taxes.

The taxpayer now seeks a refund of these amounts. It contends that the imposition of REET on an ERISA qualified plan is preempted by 29 U.S.C. § 1144(a). Alternatively, it contends that the Commerce Clause of the United States Constitution, Art. I, § 8, Cl. 3, prohibits the imposition of REET when the sale and transfer of stock occurs outside the state of Washington. In this regard, the taxpayer states that the sale and transfer of its shares of employer stock occurred in California. In support of this contention, the taxpayer submitted an affidavit by the attorney who represented the taxpayer at closing, which took place in another state. She states that "at the closing, I had custody of the stock certificates . . . and in connection with the closing of the stock purchase transaction I delivered the stock certificates" at the time of closing.

With respect to the preemption issue, the taxpayer contends that a state law that imposes REET against a qualified plan is preempted in the same manner that B&O taxes were found to be preempted in Det. No. 91-309, 11 WTD 497 (1992). It further contends that the imposition of REET places economic and

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

administrative burdens (discussed further, infra) on the taxpayer that Congress intended to preempt under ERISA. With respect to the Department's assertion that the REET provisions are saved from preemption as regulating the sale of securities, the taxpayer cites various Washington cases that distinguish between taxing statutes and regulatory statutes. See, e.g., Trimen Development v. King County, 124 Wn.2d 261, 877 P.2d 187 (1994).

ISSUES:

1.Whether this state's imposition of REET against an ESOP is preempted under ERISA's broad preemption clause and, if so, whether it is saved from preemption as the regulation of securities.

1.Whether this state's imposition of REET upon the sale in another state of a controlling interest in an entity that owns real property in this state violates the Commerce Clause of the United States Constitution.

DISCUSSION:

1. The Imposition of REET under State Law.

Except where specifically exempted, Chapter 82.45 RCW imposes an excise tax on every sale of real estate in this state at the rate of 1.28 per cent of the selling price. Additional local excise taxes are also permitted. Proceeds of these taxes are used to fund public education. RCW 82.45.180.

In the past, the transfer of the controlling interest in a corporation that owned real estate in this state did not create any REET liability on the part of the corporation or its shareholders. Under such circumstances, the corporation was the legal owner of the real estate both before and after the transfer, and individual shareholders had no property interest subject to such a tax. See Christensen v. Skagit County, 66 Wn.2d 95, 97, 401 P.2d 335 (1965). As a consequence, it was not uncommon for parties to use various forms of stock transfers and corporate mergers as a tax planning device to avoid REET on commercial real estate transactions. See AGLO 1977 No. 6.

The legislature of this state first attempted to impose tax on such transfers in 1991. SHB 1831 (ch. 22, Laws of 1991 1st sp. sess., codified at Ch. 82.45A RCW). This initial attempt proved not to be as effective as the legislature had intended, and it was repealed in 1993. In 1993, the legislature amended ch. 82.45 RCW in a new attempt to treat the transfers of controlling interests in corporations as equivalent to the sale of real property. In so doing, it expressly stated as its intent that:

> The legislature finds that transfers of ownership of entities may be essentially equivalent to the sale of real property held by the entity. The legislature further finds that all transfers of possession or use of real property should be subject to the same excise tax burdens.

Laws of 1993, ch. 25 section 501.[2]

[1] Under RCW 82.45.010, a sale for REET purposes is now defined to include:

> 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. For purposes of this subsection, all acquisitions of persons acting in concert shall be aggregated for purposes of determining whether a transfer or acquisition of a controlling interest has taken place. The department of revenue shall adopt standards by rule to determine when persons are acting in concert.

RCW 82.45.032 defines, for REET purposes, that the term real estate or real property includes the interest that shareholders have in a corporation that owns real property in this state. It provides that those terms include:

> the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land.

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[2] These amendments were patterned, in part, after New York's real estate transfer tax. See N.Y. Real Estate Transfer Tax Law Art. 31, § 1402, et. seq. (McKinney 1990).

Because no deed is recorded for such transfers, as commonly occurs with the sale of real property, transferors and transferees are directed to file a return with the Department within five days of the date of sale. RCW 82.45.090.

The Department has also promulgated rules for the administration of the REET provisions. See Ch. 458-61 WAC.

There is no dispute that the taxpayer was acting in concert with the related corporations in selling a controlling interest in the related corporations. Under WAC 458-61-025(7)(c), each seller acting in concert is "liable for its proportional share of tax based on the value of the property on the date of sale . . ."[3]

There is no provision within Chapter 82.45 RCW exempting sales by qualified plans or trusts. Accordingly, under this statutory scheme and the rules promulgated in accordance therewith, this taxpayer is liable for its proportionate share of the REET, unless the imposition of the tax is preempted or does not otherwise apply.

2. Preemption of State Law.

The taxpayer is an ESOP trust. As such, it contends that the imposition of REET upon the sale of its employer stock is preempted under the Employee Retirement Income Savings Act of 1974 (ERISA), 29 U.S.C. § 1001, et seq.

An ESOP is a tax-qualified defined contribution plan of deferred compensation under section 401(a) of the Internal Revenue Code (IRC) of 1986, as amended. ERISA defines a stock ownership plan as a plan qualified under IRC § 401 and "which is designed to invest primarily in qualified employer securities." 29 U.S.C. § 1107.

[2] Section 514(a) of ERISA provides that the act preempts "any and all State laws insofar as they may now or hereafter relate to any employment benefit plan." 29 U.S.C. § 1144(a).[4] In 1983, Congress amended ERISA to specifically provide that state tax laws that "relate to" employee benefit plans are also preempted. 29 U.S.C. § 1144(b)(5)(B)(i).[5]

In general, courts have found the scope of the preemption clause to be "as broad as its language." FMC Corp. v. Holliday, 111 S.Ct. 403 (1990), citing Shaw v. Delta Air Lines, Inc., 103 S.Ct. 2890 (1983). In general, a law is said to "relate to" a plan "if it has a connection with or reference to such a plan." Shaw, 103 S.Ct. at 2900. Courts in this state have recognized the broad reach of ERISA's preemption provision. See, e.g., Cutler v. Phillips Petroleum Co., 124 Wn.2d 749, 759, 881 P.2d 216

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[3] Although the information has been requested, the taxpayer has not identified the percentage ownership interest held by the taxpayer in the corporate stock. The record is also unclear as to which of the parties paid the REET.

[4] Section 514(b)(2)(A) of ERISA then reserves to the states the right to regulate insurance, banking, or securities. 29 U.S.C. § 1144(b)(2)(A). The Department's Taxpayer and Information Division, without first addressing the preemption issue, previously ruled that the REET provisions at issue regulated securities and, therefore, were saved from preemption.

[5] With respect to this amendment, the court in Birdsong v. Olson, 708 F. Supp. 792, 797 (W.D.Tex. 1989) noted:

The House Conference Report stated that "preemption is continued with respect to....any State tax law relating to employee benefit plans."

The Court therefore finds that Congress has expressly indicated that state tax laws related to employee welfare benefit plans are preempted.

(1994) (finding preemption of state law claims where plaintiffs alleged that an employer was motivated to terminate employees by the prospect of a pension plan windfall).

Despite the breadth of the preemption language, the Supreme Court has recognized that certain state laws "may effect employee benefit plans in too tenuous, remote, or peripheral manner to warrant a finding that the state law 'relates to' the plan." Shaw, 103 S.Ct. at 2901, n. 21. A number of jurisdictions have also held that neutral taxes of general application, which only incidentally affect plans, are not preempted by ERISA. See, e.g. Firestone Tire & Rubber Co. v. Neusser, 810 F.2d 550 (6th Cir. 1987) (holding that a two-percent tax on the income of wage earners was not preempted because it was a "neutral tax of general application"); Thiokol Corp. v. Roberts, 858 F. Supp. 674 (W.D. Mich. 1994) (holding that a value added tax, a type of sales tax, imposed on the employer was not preempted).

The law at issue here does not refer to ERISA plans; rather, it is a neutral law of general application. The only issue here is whether the REET provisions are so connected with the operation of the plan so as to require preemption or whether the provisions are too tenuous, remote or peripheral to the plan's operation so as to not warrant preemption.

In Det. No. 91-309, 11 WTD 497 (1992), a decision relied upon by the taxpayer, we held that this state's business and occupation (B&O) tax was preempted as it applied to the contributions that a qualified plan received from employers. That case, however, is not controlling. It involved a tax on the gross receipts of the plan. Here, we are concerned with a tax imposed on transactions involving real property, not on the income or gross receipts of the plan. Unlike with the B&O tax, there is no direct relationship between the income received and the amount of the transfer tax.

The taxpayer also relies on the decision in Morgan Guaranty Trust Co. of New York v. Tax Appeals Tribunal of New York, 80 N.Y.2d 44, 599 N.E.2d 656 (1992) to support its position. In that case, the court held that the imposition of New York's ten percent tax on the gains from the sale of real property was preempted by ERISA. The court noted that such a tax had a direct economic impact on the plan by taxing gains from the sale of real property: "this is not a 'cost of doing business' law, as appellants argue but a tax applied directly to the income derived from appreciation of a Plan asset." Id. at 660. The court further noted that such taxes affected the investment decisions of plan administrators, required additional record keeping and administrative costs, and were the type of taxes specifically exempted from taxation under the Internal Revenue Code. The court further noted, in dicta, that:

> As one court has noted, the gains tax is not like a stamp or documentary transfer tax--taxes generally imposed on the entire consideration paid, at a rate of less than 1%. . . . [C]ompare, Tax Law §§ 1402, 1402-a [real estate transfer tax]). Thus the gains tax is not, as appellants argue, "akin to a sales tax," and as such a "cost of doing business in New York." It is a direct tax on Plan profits.

Id. at 661.

For several reasons, we decline to follow Morgan. First, the tax at issue is not a direct tax on profits, but is more properly characterized as a cost of doing business in Washington. New York's Division of Tax Appeals has also held that state's real estate transfer tax was not preempted by ERISA, and that it did not relate to the plan in more than a tenuous, peripheral or remote manner. In re Net Realty Holding Trust, 1994 WL 424225 (N.Y.Tax Trib.). It distinguished the Morgan case and reasoned:

> The real estate transfer tax is not applied to earnings. Rather, it is a tax imposed "on each deed at the time it is delivered by a grantor to a grantee" (20 NYCRR 575.1). Since there is no direct relationship between earnings derived from the real estate conveyed by the deed and the amount of the tax, the transfer tax cannot have a direct influence on the investment strategies of pension plan fiduciaries in the same way that the gains tax might. . . . [T]he real estate transfer tax is more like the sales tax in that both are transaction taxes and, as such, a cost of doing business in New York.

Moreover, a recent Supreme Court case, New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., ___ U.S. ___, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995), signals a change in direction in the application of the preemption provision.[6] In that case, New York imposed a surcharge on patients' bills according to which company provided their health care benefits. This led, at least

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[6] This case "may well signal . . . the unhappiness with the rather sweeping deregulatory effect that an expansive reading of the words 'relate to' has had." Crull v. Gem Ins. Co., 58 F.3d 1386, 1391, n. 3 (9th Cir. 1995).

indirectly, to an increase in costs for certain qualified health benefit plans. The court held that state laws which impose indirect economic impacts on qualified plans may not be preempted by ERISA. Although that case presented a different issue than the one before us, the court's discussion regarding the "relate to" language is instructive.

The court recognized that the "relate to" language of the statute is "unhelpful" in determining the reach of the preemption clause, and that we must look to the objectives of the statute as a guide. After reviewing the legislative history, the court concluded that the "basic thrust of the preemption clause, then, was to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans." Id. at 706. The court found that the surcharges at issue did not so bind the plans or create a "conflicting directive" for plan administrators. It concluded that such laws are not preempted unless they "might produce such acute, albeit indirect, economic effects, by intent or otherwise, as to force an ERISA plan to adopt a certain scheme of substantive coverage or effectively restrict its choice of insurers." Id. at 713.

In the context of the present case, the REET provisions at issue neither create conflicting directives for plan administrators, nor bind plan administrators to a particular strategy. They also do not affect the uniform administration of the plan on a national level. Rather, the provisions simply increase the costs of doing business for the ESOP, as do numerous other local laws. We have been presented with no evidence that such costs create such an acute effect on the ESOP so as to cause preemption.

Further, the taxpayer's argument that, because the practical effect of the law is to "deplete the funds of the plan and subject the plan to reporting requirements", it must be preempted, is not persuasive.[7] With respect to administrative costs associated with the imposition of reporting requirements, such costs in and of themselves do not require preemption. For example, the administrative costs and reporting requirements imposed on a plan when it is made party to a state garnishment action do not cause preemption. Mackey v. Lanier Collection Agency & Service, Inc., 486 U.S. 824 (1988); see also, Aetna Life Ins. Co. V. Borges, 869 F.2d 142, 147 (2nd Cir.), cert. denied, 110 S.Ct. 57 (1989) (state escheat law not preempted although it has "both an economic and administrative impact").

Further, a depletion of plan assets in and of itself does not require preemption. There are numerous regulatory requirements that affect the amount of plan assets available to pay beneficiaries. ERISA, however, does not insulate a plan from the regulation of purely local transactions. United Wire, Metal & Machine Health & Welfare Fund v. Morristown Mem. Hosp., 995 F.2d 1179 (3rd Cir.) cert. denied, 114 S.Ct. 382 (1993). In this regard, the court quoted at length from Rebaldo v. Cuomo, 749 F.2d 133, 138-139 (2nd Cir. 1984), as follows:

> Insofar as the regulation of hospital rates affects a plan's cost of doing business, it also may be analogized to State labor laws that govern working conditions and labor costs, to rent control laws that determine what employer benefit plans pay or receive for rental property, and even to such minor costs as the Thruway, bridge and tunnel tolls that are charged to plans' officers or employees. In short, if ERISA is held to invalidate every State action that may increase the cost of operating employee benefit plans, those plans will be permitted a charmed existence that never was contemplated by Congress. Where, as here, a State statute of general application does not affect the structure, the administration, or the type of benefits provided by an ERISA plan, the mere fact that the statute has some economic impact on the plan does not require that the statute be invalidated.

In United Wire, at p. 1195, the court declined to find preemption, and summarized the case before it as follows:

> [W]e, too, have before us a generally applicable law which (1) is not intended to regulate the affairs of ERISA plans, (2) neither singles out such plans for special treatment nor predicates rights or obligations on the existence of an ERISA plan, and (3) does not have either the effect of dictating or restricting the manner in which ERISA plans structure or conduct their affairs or the effect of impairing the ability to operate simultaneously in more than one state.

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[7] In this regard, the taxpayer contends that sales tax imposed on purchases by a plan, which are a cost of doing business in this state, are also preempted, and the language in Morgan that might indicate otherwise is dicta. We find no authority for such a contention.

Although that case involved a state law that precluded plans from negotiating discount rates with hospitals, rather than the imposition of a transfer tax, we are presented with an analogous situation. We, too, have before us a law of general application that neither regulates the affairs of the ESOP nor restricts the manner in which it conducts its business or its ability to operate in a uniform manner on a national level.

Since the enactment of ERISA, tax-exempt entities have made substantial investments in United States realty. T. Karlin & J. Karlin, Investments by Tax-Exempt Entities in U.S. Realty, (1992 CCH Tax Trans. Lib.). Given the statutory scheme, transfers of controlling interests in entities that own real property in this state are treated the same as any transfer of real property, and a decision favorable to the taxpayer might have the effect of also preempting REET on any sale of real property in this state by a qualified plan. The same might be said of other costs of doing business, such as are caused by zoning laws, local improvement levies, and sales and use taxes. We have seen nothing in the legislative history or the case law to suggest that the preemption provision was to be applied this broadly.

Accordingly, we conclude that the imposition of REET on the transfer by a qualified plan of a controlling interest in an entity that owns real property in this state is not preempted by ERISA. Such costs are imposed by a statute of general application that does not affect the structure, the administration, or the type of benefits provided by a qualified plan. Such costs are simply a cost of doing business in this state, and such costs do not relate to a plan's operation in more than a tenuous, peripheral or remote manner.

Had we found the tax at issue to have been preempted, the next step in a preemption analysis is the savings clause, the basis upon which the Department originally denied relief. That clause provides that any state law that "regulates insurance, banking, or securities" shall remain in force. 29 U.S.C. § 1144(b)(2)(A).

In general, the savings clause must be read broadly, with due regard for a state's traditional powers in these fields. Metropolitan Life Ins. Co. v. Massachusetts, 105 S.Ct. 2380, 2389 (1985). The Ninth Circuit has recognized that the "taxation of insurance, no less than regulation, may fall within the saving clause." General Motors Corp. v. California Bd. of Equalization, 815 F.2d 1305, 1310 (9th Cir. 1987).

However, in Pilot Life Ins. Co. v. Dedeaux, 107 S.Ct. 1549, 1554 (1987), the Supreme Court cautioned that:

> A common-sense view of the word 'regulates' would lead to the conclusion that in order to regulate insurance, a law must not just have an impact on the insurance industry, but be specifically directed toward that industry.

To the extent that the tax is one specifically levied against the sale of securities, as is argued by this taxpayer, it might well fall within the scope of the saving clause. For the reasons discussed below, we do not find the tax at issue is one specifically levied on the sale of stock. Rather, it is one imposed on the transfer of the beneficial ownership of real property located in this state. Accordingly, we do not find the saving clause applicable to the tax at issue.

3. Commerce Clause.

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).

[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.

DECISION AND DISPOSITION:

The taxpayer's refund petition is denied.

DATED this 26th day of January, 1996.