

Cite as Det. No. 98-083, 17 WTD 271 (1998)

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. 98-083
	)	
...	)	Real Estate Excise Tax

[1] WAC Ch. 458-62; RCW Ch. 82.45: REAL ESTATE EXCISE TAX -- TRANSFERS OF CONTROLLING INTEREST -- LIMITED LIABILITY CORPORATIONS. The legislature has defined the sale of real property to include the transfer of a controlling interest in an entity that owns real property in this state. The transfer of a fifty percent interest in a limited liability corporation that owns real property in this state gives rise to a taxable event.

[2] WAC Ch. 458-62; RCW Ch. 82.45: REAL ESTATE EXCISE TAX -- TRANSFERS OF CONTROLLING INTEREST -- LIMITED LIABILITY CORPORATIONS -- MEASURE OF THE TAX. The measure by which the real estate excise tax is based is the selling price. By statute, the selling price on a transfer of a controlling interest is the full value of the property owned by the entity and located in this state. No allowance is made to reduce the selling price on a pro-rata basis according to the percentage of interest transferred.

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:

An owner of a 50% interest in a limited liability corporation (LLC) that owns real property in Washington protests the assessment of real estate excise tax (REET) measured by the value of the real property in Washington on the sale of the 50% interest in the LLC.<sup>1</sup>

FACTS:

Mahan, A.L.J. (successor to Breen, A.L.J.) -- In 1994 the taxpayers, who are husband and wife, and another party formed a limited liability company, . . . L.L.C., in Washington for the purpose

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

of acquiring and operating . . . , located in . . . , Washington. Each of the parties had a 50% ownership interest in the LLC.

According to the taxpayer, disputes arose between the parties as to how the LLC should be operated and managed, and the parties were unable to resolve those disputes. Because each party had equal management authority under the terms of the LLC agreement, the parties recognized either one party had to sell that interest in the LLC or a judicial partition action commenced. The taxpayers agreed to sell their interest in the LLC.

In accordance with a Purchase and Sale Agreement dated June 19, 1995, they sold the majority of their interest in the LLC to the other owner of the LLC, with the remainder of their interest sold to two individuals. The total purchase price was \$ . . . . The purchasers also agreed to assume all of the LLC's outstanding debts and liabilities. Section 11.2 of the agreement provided for payment of REET, as follows:

The parties acknowledge and agree that as a result of the sale of LLC Units contemplated hereunder Sellers are obligated to pay real estate excise tax in the amount of \$ . . . , which shall be deducted from the purchase price by Purchasers and paid to . . . County.

The taxpayers completed a Real Estate Excise Tax Affidavit showing a purchase price of \$ . . . and remitted REET in the amount of \$ . . . , which was 1.28% of the purchase price of the taxpayers' interest in the LLC. The Department of Revenue (Department) reviewed the affidavit and assessed additional excise tax in the amount of \$ . . . , representing the excise tax rate of 1.28% multiplied by the total assessed value of the land owned by the LLC in Washington (\$ . . . ), less credit for the excise tax previously paid.

The taxpayers appealed the assessment and present four arguments: (1) Under the 14th Amendment of the United States Constitution, the provisions of RCW 82.45.030(2) as applied in this case are either void or must be construed to apply on a pro-rata basis according to the interest transferred; (2) Under Article VII of the Washington State Constitution, the provisions of RCW 82.45.030(2) as applied in this case are either void or must be construed to apply on a pro-rata basis according to the interest transferred; (3) A "controlling interest" was not transferred under the facts of this case; and (4) Because of the nature of the interest transferred, the measure of the tax is limited to the value of the interest transferred, not the entire value of the property.

With respect to the constitutional arguments, the taxpayers make a two-part analysis. First, the taxpayers equate an interest in the LLC with a partnership interest, i.e., "it is proper to analogize to Washington case law addressing the relationship of partners to partnership property to determine this state's likely judicial stance in the context of members and their LLC." Because partners are often considered to own an undivided interest in partnership property, the taxpayer contends that the taxpayers should be considered to have had a 50% undivided interest in the LLC property, but were taxed on 100% of the value of the LLC property. As a result, the taxpayers claim that this alleged disparity violates the equal protection clause of the United

States Constitution. They recognize that a “rational basis” level of scrutiny would apply. The taxpayers further state:

The Department’s application of the excise tax to the entire value of the LLC’s property upon the Taxpayers’ transfer of a 50% ownership interest, and only upon the exact percentage of ownership interest transferred by a person transferring a direct interest in real estate, is supported by no identified rational basis.

The taxpayers further contend that such treatment does not bear a rational relationship to the purpose set out in WAC 458-61-025, that is, to “equalize the excise tax burdens between other sales of real property and transfers of entity ownership” interests.

With respect to their argument under the state constitution, the taxpayers contend that taxing an indirect interest at an effective rate greater than a direct interest violates the requirement that all “taxes shall be uniform upon the same class of property . . . .All real estate shall constitute one class. . . .” Wash. Const. art. 7, § 1 (amend. 14). The taxpayers further contend that, in order to avoid constitutional problems, the legislation should be construed to have REET based on a percentage of the amount of interest transferred, as was done under New York’s controlling interest provisions.

The taxpayers further contend that a controlling interest was not acquired because the parties allegedly did not act in concert when they acquired the taxpayers’ 50% interest. Finally, the taxpayers contend that the measure of the tax should be based on the price paid for the partnership interests because the sale was not an asset sale, and a non-asset sale does not take into account debt as would occur on a sale of real property.

#### ISSUES:

1. Does the transfer of a 50% interest in an LLC that owns real property in Washington result in the imposition or REET?
2. Because of state and federal constitutional issues, should the “controlling interest” REET provisions be construed to require application on a pro-rata basis according to the interest transferred?
3. Should the tax be measured on the value of the beneficial interest that was transferred, 50% of the value of the real property that was deemed transferred, or on the full value of the LLC’s real property?

#### DISCUSSION:

1. Imposition of REET on Transfer of a Controlling Interest.

Under RCW 82.45.010, a sale for REET purposes is defined to include:

[T]he 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.

(Emphasis added.)<sup>2</sup> RCW 82.45.032 defines, for REET purposes, that the terms “real estate” and “real property” include the interest that an individual has in an entity that owns real property in this state. It provides that those terms include:

[T]he ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land.

Under these provisions either the transfer or the acquisition of a controlling interest triggers REET liability. The Department has also promulgated rules for the administration of the REET provisions. See Ch. 458-61 WAC. An example provided under WAC 458-61-025(2)(b) makes it clear that a transfer of a controlling interest, even though no one acquires a controlling interest, triggers a taxable event. It provides:

(vi) Example 4. A owns 75% of the voting shares of a corporation. A transfers 25% portions of the shares in three separate and unrelated transactions to B, C and D, who are not acting in concert. A taxable transfer of a controlling interest occurs when A transfers 75% of the voting shares of the corporation, even though no one has subsequently acquired a controlling interest. The taxable event occurs upon the transfer of the controlling interest.

Accordingly, the fact that the taxpayers’ 50% interest may have been acquired by several parties who were not acting in concert does not change the taxpayers’ REET liability, if they transferred a controlling interest.

RCW 82.45.033(2) 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.

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<sup>2</sup> The legislature amended Ch. 82.45 RCW in order to treat the transfers of controlling interests in a uniform manner with other transfers of real property. In so doing, it expressly stated as its intent

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.

An LLC is a taxable entity in this state and the taxpayers transferred a fifty percent interest in that entity. That transfer gave rise to a taxable event.

In reaching this conclusion, we do not need to address taxpayers' argument that an interest in an LLC should be treated like a partnership interest, as the result would be the same. Under the applicable provisions, a transfer of a 50% beneficial interest in a partnership would similarly trigger REET liability.

## 2. State and Federal Constitutional Issues.

The taxpayers argue that RCW 82.45.030(2) is unconstitutional under the uniformity provisions of Const. art. 7, § 1 (amend. 14).<sup>3</sup> The taxpayers further argue that RCW 82.45.030(2) is unconstitutional under U.S. Const. amend. 14, § 1.<sup>4</sup> With respect to such arguments, "an administrative body does not have the authority to determine the constitutionality of the law it administers; only the courts have that power." Bare v. Gorton, 84 Wn.2d 380, 383, 576 P.2d 379 (1974); see also Det. No. 13 WTD 166 (1993). Accordingly, we decline to address the taxpayers' arguments that the controlling interest REET provisions are unconstitutional.

Taxpayers also contend that we should construe the REET provisions to require the application of REET to indirect interests on a pro-rata basis. The only support given for construing the provisions in such a manner is a reference to the New York tax statutes, which require REET to be "apportioned based on the percentage of interest transferred. . . ." N.Y. Real Estate Transfer Tax Law Art. 31, § 1402(d) (McKinney 1990).

As we recognized in Det. No. 96-006, 16 WTD 61 (1996), the REET provisions at issue 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). The Washington legislature, however, did not include an apportionment provision as was included under New York law. In general, when the legislature adopts laws of another state, all changes in words and phrasing are presumed to be deliberately made for the purpose of limiting or qualifying the adopted law. In re Eaton's Estate, 170 Wn. 280, 284, 16

<sup>3</sup> The uniformity provisions of Const. art. 7, § 1 (amend. 14) insure that "the burdens of taxation are uniformly distributed." Cosro, Inc. v. Liquor Control Bd., 107 Wn.2d 754, 759, 733 P.2d 539 (1987). However, the requirement applies only to property taxes, not to excise taxes. Id. We note that excise taxes, not property taxes, are at issue in the present case.

<sup>4</sup> In Associated Grocers, Inc. v. Washington, 114 Wn.2d 182, 787 P.2d 22 (1990), the Washington Supreme Court held, that in tax cases, the proper test to apply to equal protection cases was the "rational basis" or "minimal scrutiny" test:

(1) whether the classification applies alike to all members within the designated class; (2) whether some basis in reality exists for reasonably distinguishing between those within and without the class; and, (3) whether the challenged classification bears any rational relation to the purposes of the challenged statute. . .

Id. at 187. The taxpayers must first establish the existence of separate classes here. See Cosro, Inc. v. Liquor Control Bd., 107 Wn.2d 754, 759, 733 P.2d 539 (1987).

P.2d 433 (1932). Even if we were to consider that such a provision was inadvertently left out, we cannot read into the statute something the legislature may have inadvertently left out. Department of Labor & Industries v. Cook, 44 Wn. 2d 671, 296 P.2d 962 (1954). Accordingly, we find no support for construing the statute in such a manner as to require the application of REET to indirect interests on a pro-rata basis.

### 3. The Measure of The Tax.

The taxpayer also contends that the tax should be based on the price paid for the interest in the LLC that was transferred, not on the value of the real property owned by the LLC.

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.” RCW 82.45.060. Additional local excise taxes are also permitted. Under RCW 82.45.030, the term “selling price” is defined to include:

(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.

...

(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.

(Emphasis added.) See also WAC 458-61-025(4). The use of the work “shall” is mandatory. Under these provisions, the Department correctly assessed REET based on the value of the real property owned by the LLC. Under the circumstances, the use of the country property tax roles was also appropriate.

In reaching our conclusion, we note that the tax at issue here bears no relation to the funds received by the taxpayers for interest in the LLC. Rather, the incident giving rise to the tax is the transfer of the beneficial ownership in real property located in this state. Accordingly, the amount of the tax is based on the value of the real property, not the interest in the LLC that was transferred.

### DECISION AND DISPOSITION:

The taxpayers’ petition is denied.

Dated this 7th day of May 1998.