

Cite as Det. No. 00-083, 19 WTD 1037 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
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- [1] WAC Ch. 458-61; RCW Ch. 82.45: REAL ESTATE EXCISE TAX -- TRANSFERS OF CONTROLLING INTEREST -- 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.
- [2] WAC Ch. 458-61; RCW Ch. 82.45: REAL ESTATE EXCISE TAX -- TRANSFERS OF CONTROLLING INTEREST -- MEASURE OF THE TAX -- EXEMPTIONS -- IRC § 721. WAC 458-61-376 provides an exemption from REET for transfers that do not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization under IRC § 721. When transfers by certain partners in a limited partnership are subject to this exemption, the transfers are not considered a sale for determining whether there was a transfer of a controlling interest. However, with the exclusion of such partners' interests from the calculation, there may still be a transfer of controlling interests by the remaining partners. If so, no proportionate reduction in the

measure of the tax is allowed even though certain partnership interests were subject to the exemption.

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.

Mahan, A.L.J. – Partners in various partnerships owning real property in Washington contributed their interests in the partnerships in exchange for an interest in a limited liability company. The partners, the partnerships, and the limited liability company protest the Department of Revenue’s (Department) assessment of real estate excise tax (REET) on that portion of the value of the real property which equals the value of such partnership contributions.¹

ISSUE

On the sale of controlling interests in partnerships owning real property in Washington, is the measure of the REET reduced by the value of partnership interests contributed to a new entity, when gain or loss was not recognized under Section 721 of the Internal Revenue Code (IRC) on those contributions?

FACTS

Taxpayers . . . and their wholly-owned corporation, taxpayer . . . (hereinafter collectively referred to as “Partners”), along with numerous limited partners, owned the beneficial interest in three partnerships that owned hotel properties in Washington state, . . . , . . . , and . . . (hereinafter collectively referred to as “Partnerships”). The limited partners collectively owned the majority interests in the Partnerships.

On March 31, 1999, the Partnerships were merged into taxpayer . . . LLC, a Washington limited liability company (fka . . . LLC, and hereinafter referred to as the “LLC”), an entity beneficially owned by the Partners. In a transaction separate from the merger, the Partners, at the same time as the merger, contributed their interests in the Partnerships in exchange for interests in the LLC. The limited partners received cash for their partnership interests as part of the merger. The Partners’ contribution of their interest in the partnerships was structured as a partnership contribution transaction under 11 U.S.C. § 721, and they did not recognize any gain or loss on the transaction for federal tax purposes.

As an “agent” for the limited partners, one of the Partners signed a Real Estate Excise Tax Affidavit/Return, . . . , on each of the transfers of controlling interests to the LLC. By letter dated April 1, 1999, these returns were sent to the Department, following a closing that had occurred on March 31, 1999. A total of \$. . . in REET was paid. Neither the Partners nor the limited partners paid REET on the proportionate value of the Partners’ interests in the Partnerships. On

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

May 10, 1999, the Department assessed an additional \$. . . in REET, plus penalties and interest. On June 9, 1999, a check was drawn on the LLC account and issued to pay this REET assessment, including penalties and interest.

ANALYSIS

1. Transfers of Controlling Interests.

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.)² RCW 82.45.032 defines, for REET purposes, that the terms “real estate” and “real property” to 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 in a partnership that owns real property in Washington triggers REET liability.

2. Measure of the Tax.

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

² 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.

property located in this state cannot reasonably be determined, the selling price shall be determined according to subsection (4) of this section.

(Emphasis added.) See also WAC 458-61-025(4).

In Det. No. 98-083, 17 WTD 271 (1998), we addressed whether the REET should be measured on the value of the beneficial interest transferred (in that case 50% of the interest in a limited liability company was transferred) or the value of the real property that was deemed transferred. We held:

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 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).

Under the applicable provisions, the measure of the tax is the value of the real property, not the proportionate amount of the beneficial interest that was transferred.

3. Exemptions from the Tax.

RCW 82.45.010(3) defines the term "sale" not to include:

(o)(i) A transfer that for federal income tax purposes does not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization, including but not limited to nonrecognition of gain or loss because of application of section 332, 337, 351, 368(a)(1), 721, or 731 of the Internal Revenue Code of 1986, as amended.

In accordance with this statutory provision, WAC 458-61-376 provides an exemption from REET for transfers that do not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization under IRC § 721. WAC 458-61-025(11) describes the effect of this exemption as follows:

As the transfer and acquisition of a controlling interest in an entity which owns real estate in this state is statutorily defined as a "sale" of the real property owned by the entity, the exemptions of chapter 82.45 RCW also apply to the sale of a controlling interest.

...

(b) Example 2. X owns 100% of a corporation. X wants child, C, and corporate manager, M, to be co-owners with X in the corporation. X gives 50% of the voting stock to C and sells 33 1/3% to M. While a controlling interest in the corporation has been transferred to and acquired by C, it is not taxed because generally a gift is an exempt transfer not to be counted for purposes of determining whether a controlling interest has transferred. The sale of the 33 1/3% to M is not a sufficient interest to transfer control, and is not taxed.

The Department relied on this example in assessing the additional REET. Consistent with this example, the Department described its method of assessment as follows:

We would deduct any exempt portion of the transfer out of the calculation at the beginning. Then we would determine whether the remaining interest transferred would meet the taxable requirements of WAC 458-61-025. If it does, then tax is due on the full value of the real property owned by the entity, per RCW 82.45.030(2).

The Partners contend that REET should be measured by "the amount of cash paid to third parties attributable to Washington real estate." In other words, the tax should be based on the price paid for the interests that were transferred, and not include any amounts where no gain was recognized for federal income tax purposes.

Under RCW 82.45.010, transfers that do not involve the recognition of gain or loss under IRC § 721 are not considered a "sale" of real property. The Department correctly concluded that such transfers were not a sale for determining whether there was a transfer of a controlling interest. With the exclusion of the Partners' interests from the calculation, there was still a transfer of controlling interests by the limited partners. The measure of the tax on the transfers of controlling interests in the Partnerships was still the value of the real properties. As discussed above, no proportionate reduction in the measure of the tax is allowed even though not all of the beneficial interests were transferred. Accordingly, the Department is also sustained on the amount of the assessment.

When notice of a transfer is timely given, the purchaser is not held liable for the tax. *See* WAC 458-61-025(7). A purchaser is also not liable for penalties that may be due. *See* WAC 458-61-025(9). Accordingly, the Partners (who did not engage in a taxable transfer of beneficial interests) and the LLC (as a purchaser that gave timely notice of the transfers) may not be directly liable for the tax or penalties. However, the LLC paid the additional tax and penalties, apparently on an agency basis, in the same manner as the rest of the tax had been paid. Accordingly, we do find any basis for a refund of taxes or penalties as the taxpayers have claimed in this case.

DECISION AND DISPOSITION:

The taxpayers' petition for refund is denied.

Dated this 15th day of May, 2000.