

Cite as Det. No. 14-0288, 34 WTD 061 (2015)

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>
)	
)	No. 14-0288
. . .)	
)	Registration No. . . .
)	

[1] WAC 458-61A-101; RCW 82.45.030: REAL ESTATE EXCISE TAX (REET) – CONTROLLING INTEREST – TRUE AND FAIR VALUE. In a sale of controlling interest in an entity that holds title to real property, the measure of the REET is determined by the true and fair value of the real property conveyed. When a true and fair “selling price” cannot reasonably be ascertained, a fair market appraisal is a legitimate method for determining the true and fair value of the property and the existence of a mortgage or other encumbrance does not affect the taxable value.

[2] RCW 82.45.100: REAL ESTATE EXCISE TAX (REET) – DELINQUENCY PENALTY. REET is due at the time of sale. When REET was not reported or paid until over six months after the controlling interest transfer, and the taxpayer has not presented any evidence that its failure to report or pay the tax was beyond its control, the delinquency penalty is properly assessed.

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 limited liability company (LLC) protests the Department of Revenue’s (Department) use of an appraised value to determine the selling price of real property owned by the LLC for real estate excise tax (REET) purposes. The LLC also protests the assessment of a delinquency penalty for failing to report the REET-taxable controlling interest taxable transfer until six months after the date of transfer. Taxpayer’s petition . . . is denied.¹

ISSUES

1. Whether an appraised value of real property [may] be used as the “true and fair value,” pursuant to RCW 82.45.030 and WAC 458-61A-101(4), in assessing REET on a controlling interest transfer.

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

2. Whether, under RCW 82.45.100, the Department properly assessed a delinquency penalty when a taxpayer failed to report a REET-taxable controlling interest transfer until six months after the date of the transfer.

FINDINGS OF FACT

[Taxpayer] is an LLC that owned a parcel of property in . . . , Washington. On December 13, 2012, [Member One] and [Member Two] collectively transferred their ownership interest in Taxpayer to [Member Three]. On May 14, 2013, Taxpayer filed a LLC Renewal & Annual Report with the Washington Secretary of State and the Annual Report stated there was a transfer of controlling interest in Taxpayer in the previous year.

On June 11, 2013, the Department mailed a letter to Taxpayer requesting a Controlling Interest Affidavit be completed and filed with the Department. Taxpayer completed the Controlling Interest Affidavit and sent it to the Department on June 25, 2013. In the Affidavit, Taxpayer represented the “true and fair value” of the real property it owned was \$. . . . That amount is significantly lower than the \$. . . market value assessment for the property maintained in the . . . County property tax rolls. Taxpayer paid \$. . . in REET on the reported value of the subject real property.

On July 9, 2013, the Department’s Special Programs Division (Special Programs) sent a REET assessment to Taxpayer totaling \$. . . . That amount includes \$. . . in state and local REET, \$. . . in state and local delinquent interest, \$. . . in combined state and local delinquency penalty, a credit for the \$. . . REET payment, a tax assessment penalty of \$. . . , and \$. . . in extension interest.

Upon receiving the REET assessment, Taxpayer submitted a real property appraisal, conducted on August 1, 2012, by an accredited appraiser. That real property appraisal listed a market value of \$. . . . After receiving the appraisal by Taxpayer, the Special Programs adjusted the tax assessment to reflect \$. . . as the fair market value and a new tax assessment was issued to Taxpayer.

Taxpayer filed a timely appeal contesting the “taxable amount” used to calculate the REET assessment. Taxpayer’s petition states the property was encumbered by a mortgage totaling \$. . . . Taxpayer also states the purchase price of the 70% interest in Taxpayer purchased by Member Three was \$. . . . Taxpayer further states the remaining 30% interest in Taxpayer is \$. . . . Taxpayer adds these sums together and claims the “true and fair value” of the real property owned by Taxpayer is \$. . . .²

Taxpayer also contests the state portion of the delinquency penalty.

² Our calculations under Taxpayer’s proposed methodology results in a sum of \$. . . . For the reasons outlined below, we do not adopt Taxpayer’s valuation methodology.

ANALYSIS

REET is imposed upon the sale of real property in Washington. RCW 82.45.060. “Real property” means any interest, estate, or beneficial interest in land or anything affixed to land, including the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land. RCW 82.45.032(1). The term “sale” includes the transfer or acquisition 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 states that: “[i]n the case of a partnership, association, trust, or other entity” a “controlling interest” is defined as “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). In this matter, there is no dispute there was a sale of a controlling interest in Taxpayer and the sale was subject to REET. The issue in this case is the selling price of the subject property owned by Taxpayer for determining the REET due on the sale.

RCW 82.45.030 defines “selling price” for controlling interest sales as:

(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.

RCW 82.45.030 (2), (4) (emphasis added).

The Washington Court of Appeals in *McFreeze Corp. v. Dep’t of Revenue* also pointed out

The REET statute is not ambiguous; it uses plain language and defines essential terms The statute defines “selling price” in two ways. Under RCW 82.45.030(1), the selling price is the true and fair value of the property conveyed, presumptively the consideration paid. But RCW 82.45.030(2), the more specific subsection dealing with the transfer of a controlling interest in an entity owning real estate, defines “selling price” as the “true and fair value of the real property owned by the entity....” Thus, in the sale of an entity, the value taxed is not the consideration paid, but the value of the real estate owned by the entity.

McFreeze Corp. v. Dep’t of Revenue, 102 Wn. App. 196, 201, 6 P.3d 1187 (2000) (emphasis added).

The court in *McFreeze* explained when a controlling interest in an entity that holds title to real property is sold, the selling price for REET purposes is the value of the real property not the consideration received by the seller. Therefore, we reject Taxpayer's calculation of the "true and fair value" of the property as the sum of the remaining bank loan added to a valuation of the ownership interests in Taxpayer.

Thus, when there is a sale of a controlling interest that owns real property, the selling price, under RCW 82.45.030, is determined by the true and fair value of the real property owned by the entity. RCW 82.45.030 does not define the term "true and fair value" or explain how such value is reasonably determined. However, under RCW 82.45.450, the Department is authorized to adopt rules "for the effective administration of this chapter [Chapter 82.45]." Chapter 458-61A of Title 458 of the Washington Administrative Code contains administrative rules that the Department adopted to administer Chapter 82.45. WAC 458-61A-101(2)(c) defines the "true and fair value" as "market value, which is the amount of money a willing, but unobliged, buyer would pay a willing, but unobligated, owner for real property, taking into consideration all reasonable, possible uses of the property." WAC 458-61A-101 provides:

The measure of the tax is the "selling price." For the purpose of this rule, "selling price" means "the true and fair value of the real property owned by the entity at the time the controlling interest is transferred."

WAC 458-61A-101(4) (emphasis added.)

Thus, under RCW 82.45.030, WAC 458-61A-101(2)(c) and WAC 458-61A-101(4), for a sale of controlling interest in an entity that holds title to real property, the measure of the REET is determined by the true and fair value of the real property conveyed. To determine the selling price, we need to first determine whether the true and fair value of the real property can be reasonably determined. RCW 82.45.030; WAC 458-61A-101(4).

...

The measure of the tax is the "selling price." For the purpose of this rule, "selling price" means the true and fair value of the real property owned by the entity at the time the controlling interest is transferred.

(a) If the true and fair value of the property cannot reasonably be determined, 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 or renumbered as of January 1, 2005.

(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 will be used as the selling price.

WAC 458-61A-101(4) (emphasis added). After receiving the fair market value appraisal of the property by Taxpayer, the Special Programs issued an adjusted tax assessment reflecting the \$. . . fair market value. We sustain the Special Program's adjustment of the tax assessment to use the appraised value of the subject property as the true and fair value of the property subject to REET [in accordance with WAC 458-61A-101(4)(a)(i)].

Taxpayer also contests the assessment of the state delinquency penalty. RCW 82.45.100 provides:

- (1) Payment of the tax imposed under this chapter is due and payable immediately at the time of sale, and if not paid within one month thereafter will bear interest from the time of sale until the date of payment.

. . . .

- (2) In addition to the interest described in subsection (1) of this section, if the payment of any tax is not received by the county treasurer or the department of revenue, as the case may be, within one month of the date due, there is assessed a penalty of five percent of the amount of the tax; if the tax is not received within two months of the date due, there will be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within three months of the date due, there will be assessed a total penalty of twenty percent of the amount of the tax. The payment of the penalty described in this subsection is collectible from the seller only, and RCW 82.45.070 does not apply to the penalties described in this subsection.

RCW 82.45.100(1), (2). The REET Controlling Interest Transfer Affidavit was not received timely in this case. The controlling interest transfer occurred on December 13, 2012 and REET was not reported or paid until June 25, 2013. Taxpayer has not presented any evidence that its failure to report or pay the tax was beyond its control. *See* RCW 82.32.105. For these reasons, we hold that the delinquency penalty was properly assessed.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 10th day of September, 2014.