

Cite as Det. No. 15-0138, 35 WTD 140 (2016)

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. 15-0138
)	
...)	Registration No. . . .
)	
...)	Registration No. . . .
)	

[1] WAC 458-61A-101; RCW 82.45.010 REAL ESTATE EXCISE TAX (REET) – OWNERSHIP INTEREST – REDEMPTION OF OWNERSHIP INTEREST. The redemption of ownership interests constitutes a “transfer” or “acquisition of a controlling interest in an LLC that requires payment 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.

Lewis, A.L.J. – Taxpayers’ petition for the correction of a Real Estate Excise Tax (“REET”) assessment claiming that the change in ownership in limited liability companies (LLCs), which resulted from the redemption of other members’ ownership interests, did not constitute a REET-taxable transaction. Taxpayer’s petition is denied.¹

ISSUE:

1. Whether the change in ownership in two LLCs that resulted from related members redeeming their ownership interest were “Acts in Concert” that required aggregation for purposes of determining whether a transfer or an acquisition of a controlling interest had taken place.
2. Did redemption of the ownership interests constitute a “transfer” or “acquisition” of a controlling interest in the LLCs subject to REET under RCW 82.45.010(2) and WAC 458-61A-101.

FINDINGS OF FACT:

[Taxpayers] are entities that own real estate in Washington. During 2013, each Taxpayer redeemed ownership interests of certain members. When Taxpayers redeemed the interests of some members, the ownership percentages of the remaining owners increased. The percentages are recorded in the below charts.

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

[Taxpayer 1]		
Owners	Prior Redemption Ownership Percentage	Post Redemption Ownership Percentage
[Owner 1]	15%	30%
[Owner 2]	20%	0%
[Owner 1 Irrevocable Trust]	10%	20%
[Owner 2 Irrevocable Trust]	10%	0%
[Owner 3 2012 Family Trust]	25%	50%
[Owner 4 2012 Family Trust]	10%	0%
[Owner 5 2012 Family Trust]	10%	0%
Total	100%	100%

[Taxpayer 2]		
Owners	Prior Redemption Ownership Percentage	Post Redemption Ownership Percentage
[Owner 1]	5%	10%
[Owner 2]	5%	0%
[Owner 1 Irrevocable Trust]	25%	50%
[Owner 2 Irrevocable Trust]	25%	0%
[Owner 3 2012 Family Trust]	20%	40%
[Owner 4 2012 Family Trust]	10%	0%
[Owner 5 2012 Family Trust]	10%	0%
Total	100%	100%

[Owner 1] and [Owner 2] are brothers; [Owner 3] is [Owner 1's] wife; and, [Owner 4] and [Owner 5] are [Owner 2's] daughters. [Owner 1] and [Owner 2] have historically been equal owners and the 2012 trusts were put in place for estate planning purposes. The redemption of [Owner 2] and his daughters' ownership interests left the [Owner 3 2012 Family Trust] with a controlling interest in [Taxpayer 1] and the [Owner 1 Irrevocable Trust] with a controlling interest in [Taxpayer 2].

On March 5, 2014, Taxpayers' representative sent to the Department of Revenue's ("Department") Special Programs a REET Affidavit Controlling Interest Transfer Return ["Return"] claiming a REET exemption. On March 10, 2014, following the review of the [Return], Special Programs sent [Taxpayer 1] a \$. . . REET assessment.² On March 10, 2014, the Department also issued [Taxpayer 2] two assessments totaling \$³ The Assessments included the following explanation:⁴

² Assessment No. . . . was issued in the amount of \$. . . and included: \$. . . tax, \$. . . audit interest, and \$. . . assessment penalty.

³ Assessment No. . . . was issued in the amount of \$. . . and included: \$. . . tax, \$. . . audit interest, and \$. . . assessment penalty. Assessment No. . . . was issued in the amount of \$. . . tax, \$. . . audit interest, and \$. . . assessment penalty.

⁴ Tax was calculated on a sales price of \$. . . , which was based on the value of real property parcels reported.

You claimed an exemption from the tax stating that it was a mere change in identity. This transfer resulted in the grantors and grantees having a different proportional interest in the property. The family LLC portion of this exemption does not apply since the exemption only applies to transfers to an entity, owned by the transferor and/or the transferor's child.

WAC 458-61A-211

Mere change in identity or form – Family corporations and partnerships.

Introduction. A transfer of real property is exempt from real estate tax if it consists of a mere change in identity or form of ownership of an entity. This exemption is not limited to transfers involving corporations and partnerships, and includes transfers of trusts, estates, associations, limited liability companies and other entities. If the transfer of real property results in the grantor(s) having a different proportional interest in the property after the transfer, real estate excise tax applies. . . .

(5) **Family corporations, partnerships, or other entities.** This exemption applies to transfers to an entity that is wholly owned by the transferor and/or the transferor's spouse children, regardless of whether the transfer results in a change in the beneficial ownership interest. . . .

On April 9, 2014, Taxpayers requested and received a 30-day extension on payment. Taxpayers claimed an exemption under WAC 458-61A-211. Subsequently, Special Programs denied Taxpayers' claimed exemptions, reasoning:

The transfer of a controlling interest in an entity that has an interest in real property in this state is considered a taxable sale of the entity's real property for purposes of the real estate excise tax under chapter 82.45 RCW. There was a 50% change in the controlling interest of [Taxpayer 1] and the entity owns real property in Washington.

RCW 82.45.010 also defines the term sale as including 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.

There has been a 50% change in the controlling interest of [Taxpayer 1] that does not qualify for an exemption under WAC 458-61A-211. REET is due.

On June 6, 2014 Taxpayers appealed the assessments. On appeal, Taxpayers maintained that the redemption of ownership interests by Taxpayers was not sufficient to create a transfer of a controlling interest because no party transferred or acquired 50% or more of the capital, profits, or beneficial interest in Taxpayers through the redemptions. Thus, even if a party will own a controlling interest after a transfer, it is not a transfer of a controlling interest if the amount transferred itself is not a controlling interest. See WAC 458-61A-101(2)(Example A). Here no party transferred or acquired a controlling interest in either Taxpayer, so there was no transfer of a controlling interest to transfer REET

ANALYSIS:

REET is imposed upon the sale of real property in Washington. RCW 82.45.060. RCW 82.45.010 defines “sale” to include: “[A]ny conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property . . . for a valuable consideration.” RCW 82.45.010(1).

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.” RCW 82.45.010(2). RCW 82.45.033(1)(b) 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.” RCW 82.45.033(1)(b); *see also* WAC 458-61A-101(2)(a)(ii) (“Rule 458-61A-101”). Stated succinctly, in Det. No. 97-240R, 21 WTD 145 (2002):

There are two prerequisites for imposition of the tax: (1) the transfer of an interest in real property or controlling interest in a realty-holding entity; and (2) consideration paid or contracted to be paid in exchange for the transfer. *State ex rel Namer, Inc. v. Williams*, 73 Wn.2d 1, 435 P.2d 975 (1968).

21 WTD at 147.

Taxpayers argue that the extinguishment of [Owner 2’s] and his daughters’ interest in Taxpayers did not constitute a transfer or acquisition of a controlling interest. In support of this argument, Taxpayer relies on an example contained in WAC 458-61A-101(2)(a)(ii)(A):

Able and Baker each own 40% of the voting shares of a corporation, Flyaway, Inc. Charlie, Delta, Echo, and Frank each own 5% voting shares. Charlie acquires Baker’s 40% interest, and Delta’s and Echo’s 5% interests. This is a taxable acquisition because a controlling interest (50% or more) was acquired by Charlie (40% from Baker plus 5% from Delta and 5% from Echo). However, if Charlie, Delta, and Echo were to transfer their shares (totaling 15%) to Able, those transfers would not be taxable. Although Able would own 55% of the corporation, only a 15% interest was transferred and acquired, so the acquisition by Able is not taxable.

In the example, Able’s acquisitions from Charlie, Delta, and Echo, totaled [15%] and even when aggregated do not rise to a controlling interest. The facts of Taxpayers’ cases are different, because when the acquisitions by persons “acting in concert” are aggregated, then there was a transfer or acquisition of a controlling interest.

RCW 82.45.010(2) explains that:

(c) ...all acquisitions of persons acting in concert must be aggregated for purposes of determining whether a transfer or an acquisition of a controlling interest has taken place.

Rule 458-61A-101(2)(a)(F)(e)(ii) explains that “acting in concert” occurs:

Where buyers are not commonly controlled or owned, but the unity of purpose with which they have negotiated and will complete the acquisition of ownership interests, indicates that they are acting together. For example, three separate individuals who decide together to acquire control of a company jointly through separate purchases of 20% interests in the company act in concert when they acquire the interests.

Because of the family relationship among the parties, we conclude that the individuals and trusts acquiring interests in the two LLCs were persons “acting in concert”. “Acting in concert” for [Taxpayer 1], [Owner 1] acquired 15%, the [Owner 1 Irrevocable Trust] acquired 10%, and the [Owner 3 2012 Family Trust] acquired 25% for a total of 50%. “Acting in concert” for [Taxpayer 2], [Owner 1] acquired 5%, the [Owner 1 Irrevocable Trust] acquired 25%, and the [Owner 3 2012 Family Trust] acquired 20% for a total of 50%. Thus, the acquisitions when aggregated constitute a transfer or acquisition of a controlling interest that requires payment of REET. Accordingly, we sustain the REET assessments.

DECISION AND DISPOSITION:

Taxpayers’ petitions are denied.

Dated this 28th day of May, 2015.