

Cite as Det. No. 15-0329, 35 WTD 355 (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. 15-0329 |
| |) | |
| ... |) | Registration No. . . . |
| |) | |

[1] WAC 458-61A-211; RCW 82.45.010(3)(p) – REET – CONTROLLING INTEREST TRANSFER – EXEMPTIONS – MERE CHANGE – CHANGE IN BENEFICIAL OWNERSHIP: Taxpayer’s acquisition of a 52.5% interest in a limited liability company (LLC) pursuant to a unit redemption agreement resulted in a change in beneficial interest in the real property, and therefore the transaction did not qualify for an exemption as a mere change in identity or form of ownership under WAC 458-61A-211 and RCW 82.45.010(3)(p).

[2] WAC 458-61A-212; RCW 82.45.010(3)(q)(i); TITLE 26 I.R.C. – REET – CONTROLLING INTEREST TRANSFER – EXEMPTIONS – NONRECOGNITION OF GAIN OR LOSS – BURDEN OF PROOF: Taxpayer failed to produce proof to meet its burden of showing that its acquisition of a 52.5% interest in an LLC qualified for the exemption provided in WAC 458-61A-212 and RCW 82.45.010(3)(p), which is limited to transfers under Title 26 of the Internal Revenue Code that involve “entity formation, liquidation or dissolution, and reorganization.”

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.

LaMarche, A.L.J. – Taxpayer, a limited liability company (LLC) that owns real property in Washington, appeals the assessment of real estate excise tax (REET) on its transfer of a controlling interest, asserting that the transfer is exempt from REET because it was nontaxable under federal law, or was a mere change in form or identity. Taxpayer alternatively asserts that if REET is due on the transfer, the value of the LLC’s real property is significantly less than that asserted by the Department. We conclude that REET is due on the transfer, but the assessment must be adjusted to remove liability for a second parcel assessed in error, and to reflect a professional appraisal later submitted by Taxpayer. We grant the petition in part, deny it in part.¹

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

ISSUES

1. Under RCW 82.45.010(3)(p)² and WAC 458-61A-211, is the transfer of a controlling interest in an LLC that owns real property in this state exempt from REET as a “mere change” in form or identity?
2. Under RCW 82.45.010(3)(q)(i)³ and WAC 458-61A-212, has Taxpayer shown that the controlling interest transfer is exempt from REET as a transfer that does not involve the recognition of gain or loss under Internal Revenue Code § 721?
3. Under RCW 82.45.030(2) and WAC 458-61A-101(2)(c) and (4), was REET assessed on the true and fair value of the controlling interest transferred?

FINDINGS OF FACT

[Taxpayer] is a holding company whose only asset is a parcel of real property in Washington State, Parcel No. . . . at . . . , Washington (Parcel One). [Seller], transferred a 52.5% controlling interest in Taxpayer on December 23, 2013, pursuant to a unit redemption agreement (Agreement). See Unit Redemption Agreement, Audit File dated October 27, 2014. The Agreement provided that Seller would convey all of its 52.5% interest to the Company, in exchange for \$. . . paid by check, \$. . . , representing the balance in Taxpayer’s company checking account, and \$. . . representing a rent payment. Unit Redemption Agreement, *supra*. No REET Controlling Interest Transfer Return was filed with the Department of Revenue for the December 23, 2013, transaction.

On August 4, 2014, Taxpayer filed an LLC Renewal and Annual Report with the Washington Secretary of State, which indicated that there had been a transfer of a controlling interest in Taxpayer, and that Taxpayer owned real property in Washington. The Department’s Special Programs Division (Special Programs) sent a letter to Taxpayer on August 11, 2014, inquiring about the transfer, and requesting that Taxpayer complete and return a REET Controlling Interest Transfer Return. Special Programs did not receive a reply to that letter, nor did it receive a reply to the second letter it sent on September 5, 2014.

On October 6, 2014, Special Programs issued a REET assessment of \$. . . , based on a total county assessed value for tax year 2014 of \$. . . , representing 100% of the combined values on the county tax rolls for Parcel One, valued at \$. . . , and Parcel No. . . . at . . . WA (Parcel Two), valued at \$. . .⁴

² RCW 82.45.010(3)(o) was renumbered as RCW 82.45.010(3)(p) in the Legislature’s 2014 amendments effective June 12, 2014. See Laws of 2014, ch. 58, § 24. Because there was no substantive change in the statutory provision we discuss here, we shall use the more recent numbering under the 2014 amendments throughout our discussion.

³ RCW 82.45.010(3)(p)(i) was renumbered as RCW 82.45.010(3)(q)(i) in the Legislature’s 2014 amendments effective June 12, 2014. Because there was no substantive change in the statutory provision we discuss here, we shall use the numbering under the 2014 amendments throughout our discussion. See note 2.

⁴ The assessment, Document No. . . . , issued on October 6, 2014, totaled \$. . . and was comprised of \$. . . in REET (\$. . . in State REET, and \$. . . in Local REET), \$. . . interest, a delinquent return penalty of \$. . . , and an assessment (substantial underpayment) penalty of \$ The assessment was based on a total market value of \$ The due date on the assessment was November 6, 2014.

The assessment was reissued in the amount of \$. . . on October 27, 2014, to correct the date of the controlling interest transfer, and to more accurately identify the transferor and transferee in the transaction.⁵ Taxpayer filed an appeal on November 24, 2014, which the Department received on December 2, 2014. After filing the appeal, Taxpayer submitted a real property appraisal, completed on August 14, 2013, by an accredited appraiser, which reported the value of a Fee Simple interest in Parcel One as of July 25, 2013, of \$⁶ Taxpayer also provided copies of quit claim deeds showing that the Company had never owned Parcel Two, and that an unrelated party had inadvertently misspelled the name of the transferee on a deed, making it appear the same as Taxpayer's, but later filed a deed correcting the error; however, the county recorder's office failed to correct the error on its internet site.⁷

ANALYSIS

1. Controlling Interest Transfer and Mere Change

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 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).⁸ 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). Taxpayer does not dispute that the transfer was a transfer of a controlling interest.

Under RCW 82.45.080(1), payment of REET in real estate transactions is the obligation of the seller. In the case of a transfer or acquisition of a controlling interest in an LLC, the Department may also, at the Department's option, either enforce the seller's obligation to pay REET against the LLC, or against the person or persons who transferred or acquired the controlling interest in the entity. RCW 82.45.033(2)(b).

The term "sale" does not include, "A transfer of real property, however effected, if it consists of a mere change in identity or form of ownership of an entity where there is no change in the beneficial ownership." RCW 82.45.010(3)(p).

WAC 458-61A-211, the Department's administrative rule implementing the REET exemption for mere change in identity or form of ownership, provides in part:

⁵ The assessment, Document No., reissued on October 27, 2014, corrected the transfer date and associated interest. The updated total was \$. . . , and was comprised of \$. . . in REET (\$. . . in State REET, and \$. . . in Local REET), \$. . . interest, a delinquent return penalty of \$. . . , and an assessment (substantial underpayment) penalty of \$ The due date on the assessment was November 26, 2014. In addition to Taxpayer, the October 6, 2014 assessment was sent to ". . ." and ". . .", which were changed to ". . ." and ". . .," respectively.

⁶ See . . . , Summary Appraisal Report, August 14, 2013, Taxpayer correspondence dated January 23, 2015.

⁷ See Deeds of Trust, Taxpayer correspondence dated March 10, 2015.

⁸ RCW 82.45.010 was amended in 2014 to address certain transfers not at issue here. RCW 82.45.010(2)(a) was not affected by the 2014 amendments. See note 2.

(1) **Introduction.** A transfer of real property is exempt from the real estate excise tax if it consists of a mere change in identity or form of ownership of an entity. . . . 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.

Here, the controlling interest transfer resulted in a change in the beneficial ownership of Taxpayer, and is not a mere change in identity or form of ownership. RCW 82.45.010(3). Seller, the grantor, transferred all of its ownership interest in Taxpayer, which included all of its interest in Parcel One. Before the transfer, Seller had a 52.5% interest in Taxpayer, and after the transfer, Seller had 0% interest in Taxpayer. Clearly, the transfer resulted in the Seller/grantor having a different proportional interest in the property after the transfer. WAC 458-61A-211. Therefore, Taxpayer has not shown that the transfer was a “mere change in identity or form of ownership,” and accordingly, the transfer does not qualify for the “mere change” exemption. RCW 82.45.010(3); WAC 458-61A-211; *see also* Det. No. Det. No. 14-0004, 34 WTD 79 (2015).

2. Nontaxable Transactions

Certain transfers not recognized for federal tax purposes are not subject to REET. RCW 82.45.010(3)(q)(i) excludes from the definition of “sale”:

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.

The Department adopted WAC 458-61A-212 to administer the exemption for transfers where gain is not recognized under the Internal Revenue Code, which states, in part, “(1) **Introduction.** 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, is not subject to [REET]. . . .”

Tax benefits and all other deductions, exemptions, and credits, must be strictly construed, though fairly, and in keeping with the ordinary meaning of their language, against the taxpayer. *See, e.g., Budget Rent-a-Car, Inc. v. Dep’t of Revenue*, 81 Wn. 2d 171, 500 P.2d 764 (1972); *Group Heath Coop. v. Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967); Det. No. 07-0034E, 26 WTD 212 (2007). “The burden of showing qualification for the tax benefit afforded . . . rests with the taxpayer.” Thus, Taxpayers must prove they are entitled to the benefit. *Group Health*, 72 Wn.2d at 429. Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932). Exemptions from a taxing statute must be narrowly construed. *Budget Rent-A-Car*, 81 Wn.2d at 174; *Evergreen-Washelli Memorial Park Co. v. Dep’t of Revenue*, 89 Wn.2d 660, 663, 574 P.2d 735 (1978).⁹

Here, although Taxpayer had ample opportunity to provide documents, it provided nothing to support its assertion that the controlling interest transfer qualifies for an exemption from REET

⁹ *See also* Det. No. 14-0217, 33 WTD 623 (2014), Det. No. 14-0386, 34 WTD 273 (2015).

under WAC 458-61A-212. Therefore, we conclude that Taxpayer has not met its burden of proving that the controlling interest transfer qualifies for the exemption.

3. Measure of Tax for Controlling Interest Sales

[Under RCW 82.45.060, REET is measured by the “selling price,” which is defined in RCW 82.45.030.]

WAC 458-61A-101, adopted by the Department to administer taxation of controlling interest transfers, states that the measure of tax for REET purposes is the “selling price,” and says:

. . . 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)(a) and (b); *see also* RCW 82.45.030(2).

Here, prior to the assessment, Taxpayer did not respond to Special Program’s request for documentation. Special Programs, therefore, based the assessment on the values shown on the county property rolls for all properties in the state owned by Taxpayer, pursuant to RCW 82.45.030(4) and WAC 458-61A-101(4)(b). However, after Taxpayer filed its appeal, it provided a professional appraisal of the property showing a value of \$. . . for Parcel One as of July 25, 2013.

Special Programs has agreed that the measure of the tax on the controlling interest transfer should be based solely on the true and fair value of Parcel One as shown on Taxpayer’s fair market appraisal in accordance with WAC 458-61A-101(4)(a). *See also* RCW 82.45.030(2).

In conclusion, we deny Taxpayer’s petition as to its claims for exemption, and conclude that Taxpayer is liable for REET . . . pursuant to RCW 82.45.080(1) and RCW 82.45.033(2)(b). However, we grant the petition as to the correct measure of tax on the controlling interest transfer, including removal of Parcel Two from the assessment, and have adjusted the assessment accordingly.

DECISION AND DISPOSITION

Taxpayer's petition is granted in part and denied in part.

Dated this 24th day of November, 2015.