

Cite as Det. No. 16-0135, 35 WTD 577 (2016)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for)	<u>D E T E R M I N A T I O N</u>
Refund of)	
)	No. 16-0135
)	
...)	Registration No. . . .
)	

[1] RCW 82.45.010; WAC 458-61A-101: REAL ESTATE EXCISE TAX – TRANSFER OF A CONTROLLING INTEREST. Real estate excise tax is due when 50 percent or more of the interest in an entity that owns real property is transferred or acquired within a 12-month period. When multiple transactions occur within a 12-month period, a controlling interest transfer occurs when the interest is either transferred by a single person, or acquired by a single person.

[2] RCW 82.45.030; WAC 458-61A-101: REAL ESTATE EXCISE TAX – CONTROLLING INTEREST TRANSFER – MEASURE OF TAX – *McFreeze Corp. v. Dep’t of Revenue*, 102 Wn. App. 196, 6 P.3d 1187 (2000). In the case of a controlling interest transfer, the amount of real estate excise tax owed is measured by the fair market value of the real property as a whole, not the value of the interest that was 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.

Poley, T.R.O. – A limited liability company [(LLC)] that owns real property in Washington protests the assessment of real estate excise tax [(REET)] on the value of the property upon the transfer of two one-third shares in the company to the holder of the remaining one-third share. We conclude that the sole remaining owner of the company acquired a controlling interest, causing imposition of [REET] on the full value of real property owned by the company. The assessment is affirmed.¹

ISSUES

1. Does the transfer of two-thirds interest in a [LLC] that owns real property in Washington constitute a transfer or acquisition of a controlling interest, triggering the imposition of [REET] under RCW 82.45.010 and WAC 458-61A-101?

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

2. Is [REET] calculated proportionally to the percentage of interest in real property that was transferred under RCW 82.45.030 and WAC 458-61A-101?

FINDINGS OF FACT

[Taxpayer] owns seven parcels of real property in . . . , Washington. On July 16, 2015, [Manager] submitted a [LLC] renewal and annual report on behalf of Taxpayer (Renewal). The Renewal listed Manager as the sole manager of Taxpayer, and indicated that a controlling interest transfer had occurred in the previous year. Taxpayer did not complete a controlling interest affidavit as required by the Department of Revenue (Department).

Shortly thereafter, the Department's Special Programs Division contacted Manager to obtain information related to the transfer of interest by Taxpayer's members. The Department learned that Taxpayer was created in 1997 under a [LLC] formation agreement (Agreement). Prior to 2015, Taxpayer was owned in equal one-third shares by Manager, [Member 1] and [Member 2] (together, Members). Manager and Members are related through the marriage of their parents. The Agreement allows a member to withdraw from Taxpayer upon approval from the other members. The Agreement also limits the amount due to a withdrawing member to no more than 50 percent of the value of the member's interest.

According to Manager, on March 8, 2015, [Member 1] contacted Manager and requested to withdraw from Taxpayer. Then, on May 9, 2015, [Member 2] contacted Manager and also requested to withdraw from Taxpayer. Manager negotiated separately with [Member 1] and [Member 2], and each agreed to accept \$. . . from Taxpayer in exchange for their interest in Taxpayer. This amount is less than the limit provided for in the Agreement.

On June 10, 2015, Manager and Members signed a manager's consent form, agreeing to [Member 1's] request to withdraw from Taxpayer. Also on that day, Manager and Members signed another manager's consent form, agreeing to [Member 2's] request to withdraw from Taxpayer. Manager prepared separate bills of sale for [Member 1] and [Member 2] to each withdraw from Taxpayer in exchange for \$ On June 18, 2015, Members signed their respective bills of sale. Manager mailed separate checks to Members on June 26, 2015. As the sole remaining member, Manager now held 100 percent interest in Taxpayer.

The Department determined that [REET] was owed on Taxpayer's real property upon the transfer of interest from Members to Manager. The Department issued a REET adjusted assessment on October 6, 2015, for \$. . . , which included \$. . . in tax, \$. . . in penalties, and \$. . . in interest. [Member 2] paid the amount of the assessment and Taxpayer timely petitioned for a refund.

Taxpayer agrees that together, Members transferred a controlling interest during 2015. However, Taxpayer claims that Members were not acting in concert, and therefore the Department should not aggregate the transfer of their interests in determining whether REET should be imposed. Taxpayer also claims that only 67 percent of the value of the property should be subject to REET as Manager only acquired 67 percent interest in Taxpayer as a result of the transfer.

ANALYSIS

REET is imposed on each sale of real property located within Washington. RCW 82.45.060. RCW 82.45.010(1) defines “sale” to include: “any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property ... for a valuable consideration.”

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)(a). In the case of a partnership, association, trust, or other entity, a “controlling interest” means “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); WAC 458-61A-101(2)(a)(ii).

WAC 458-61A-101(3) explains that in order for REET to apply when the controlling interest in an entity that owns real property is transferred, the following must have occurred:

- (a) The transfer or acquisition of the controlling interest occurred within a twelve-month period. . . .
- (b) The controlling interest was transferred in a single transaction or series of transactions by a single person or *acquired by a single person* or a group of persons acting in concert;
- (c) The entity has an interest in real property located in this state;
- (d) The transfer is not otherwise exempt under chapters 82.45 RCW and 458-61A WAC; and
- (e) The transfer was made for valuable consideration.

(Emphasis added.)

Taxpayer claims that Members were not acting in concert and the transfer of their interests should not be aggregated. However, as WAC 458-61A-101(3)(b) makes clear, it is immaterial whether *sellers* of a controlling interest acted in concert; the rule only requires that a group of *purchasers* acted in concert. Thus, whether Members acted in concert is irrelevant to the outcome of this case.

WAC 458-61A-101(6)(d)(ii) contains an example illustrating that REET is owed when a purchaser acquires a controlling interest from multiple sellers within a twelve-month period regardless of whether the sellers acted in concert:

Matt acquires a 10% interest in an entity which owns an apartment building under construction worth 500,000 from Simon on January 30th. On July 30th Matt acquires a 30% interest in the same entity from Mary, but the building is now worth \$900,000. On September 30th Matt acquires a 10% interest in the same entity from Ruth, but the

building is now worth \$1,000,000. *These are three separate and completely independent transfers.* The final transfer allowed Matt to acquire, within twelve months, a controlling interest in an entity that owns real property. September 30th is the date of sale.

(Emphasis added.) This example specifically involves acquisition of a controlling interest from multiple sellers over a period of time, just as is the case here.

Members transferred their interests to Taxpayer in exchange for \$. . . each. At that point, the sole remaining owner, Manager, acquired an additional two-thirds interest in Taxpayer that previously belonged to Members. For this reason, we conclude that Manager acquired a controlling interest in Taxpayer regardless of whether Members acted independently or in concert. Accordingly, we find that Manager's acquisition of a controlling interest constitutes a "sale" under RCW 82.45.010(2)(a), triggering liability for REET on the value of Taxpayer's real property.

Taxpayer contends that the measure of REET should be proportional to the interest that Manager acquired in Taxpayer. As Manager acquired a 67 percent interest in Taxpayer, Taxpayer argues that REET should be calculated on 67 percent of the value of the real property owned by Taxpayer, not on the full value. However, this argument is not supported by the applicable statutes, rules, and case law.

When real property is sold in Washington, REET is imposed based on the "selling price." RCW 82.45.060. The term "selling price" is defined under RCW 82.45.030. That statute provides, in pertinent part:

(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.) WAC 458-61A-101(4)(c)(iii) offers a relevant example:

An LLC owns real property and consists of two members, Frances and George. Each has a 50% LLC interest. Frances transfers her 50% interest to George. In exchange for the transfer, George pays Frances \$100,000. The true and fair value of the real property owned by the LLC is unknown. There is no debt on the real property. A fair market value appraisal is not available. The market value assessment for the property maintained on

the county property tax rolls is \$275,000. The taxable selling price is the market value assessment, or \$275,000.

The Washington Court of Appeals addressed this issue in *McFreeze Corp. v. Dep't of Revenue*, 102 Wn. App. 196, 6 P.3d 1187 (2000). There, the court found that in the sale of a controlling interest of a corporation, partnership, or other entity that owns Washington real property, “the value taxed is not the consideration paid, but the value of the real estate owned by the entity.” *Id.* at 201, 6 P.3d at 1190. The court went on to explain that “nothing in the statutes authorizes the taxpayer to apportion the tax. . . . If the sale is 49 percent or less of the entity, no tax is owed. But if the sale is 50 percent or more, tax is owed on the full value of the real estate owned by the entity.” *Id.*

Accordingly, the amount of REET at issue here bears no relation to the proportional interest transferred from Members to Manager. Members’ transfer of their interest in Taxpayer is the incident giving rise to the imposition of REET; it does not factor into the measure of REET. *See* Det. No. 98-083, 17 WTD 271 (1998). Rather, the amount of REET assessed is based on the full value of the real property, not a percentage of the value.

Here, Taxpayer did not provide documentation of the true and fair value of its real property at the time of the transfer of a controlling interest, and thus the Department was unable to reasonably determine the property’s value. Therefore, the Department correctly assessed REET on the market values shown for Taxpayer’s real property on the county property tax rolls.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 5th day of April, 2016.