

Cite as Det. No. 17-0033, 36 WTD 496 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 17-0033
	)	
...	)	...
	)	

RCW 82.45.010(3)(j); WAC 458-61A-208: REAL ESTATE EXCISE TAX – CONTROLLING INTEREST TRANSFER - DEFINITION OF “SALE” – TRANSFER OR CONVEYANCE MADE PURSUANT TO AN ORDER OF SALE BY THE COURT IN ANY MORTGAGE, DEED OF TRUST, OR LIEN FORECLOSURE. The transfer of a controlling interest in a limited liability company (“LLC”) pursuant to a court approved bankruptcy auction constitutes a “sale” subject to REET. The court approved bankruptcy auction was unrelated to a mortgage, deed of trust, or lien foreclosure proceeding and the transfer was not the result of an “execution of a judgment.”

RCW 82.45.010(3)(e); WAC 458-61A-204: REAL ESTATE EXCISE TAX – CONTROLLING INTEREST TRANSFER – DEFINITION OF “SALE” – THE PARTITION OF PROPERTY BY TENANTES IN COMMON. The transfer of membership interests in an LLC that owns real property does not constitute a partition of property by tenants in common because such real property is owned by the LLC and not owned by tenants in common.

RCW 82.45.010(3)(n); RCW 82.45.020: REAL ESTATE EXCISE TAX – CONTROLLING INTEREST TRANSFER – DEFINITION OF “SALE” AND “SELLER” – SALE BY THE UNITED STATES – BANKRUPTCY TRUSTEE. Property included in the bankruptcy estate does not become property of the United States and the bankruptcy trustee’s sale of such property is not a sale by the United States. Further, a Federal bankruptcy trustee is explicitly included within the definition of seller under RCW 82.45.020.

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.

Stojak, T.R.O. – A LLC with real property in Washington appeals the assessment of real estate excise tax (REET) on the controlling interest sale of the LLC obtained pursuant to an auction

ordered by a bankruptcy court. The LLC contends that the sale is not subject to REET pursuant to a number of exemptions provided in RCW 82.45.010(3). We deny the petition.<sup>1</sup>

### ISSUE

Whether, under RCW 82.45.010, the transfer of a 50% interest in a LLC with Washington real property by a bankruptcy trustee pursuant to a court approved auction is a “sale” subject to REET.

### FINDINGS OF FACT

[Male 1] and [Female 1 (Couple 1)] and [Male 2] and [Female 2 (Couple 2)] each owned 25% of [LLC], which owns an office building in . . . , Washington. The office building is a commercial building out of which [Male 1] and [Male 2] operated their law practice until 2013. In 2013, [Couple 2] filed for Chapter 7 bankruptcy protection and . . . , the bankruptcy trustee (“Trustee”), received an offer from [Male 1] to purchase [Couple 2’s] 50% interest in the LLC.<sup>2</sup> [Couple 2] opposed the sale and after a contested hearing on July 22, 2015, the bankruptcy court ordered the trustee to conduct a “live auction.” [Male 1] was the successful bidder at the court ordered live auction. Accordingly, on August 28, 2015, the bankruptcy court entered an order authorizing the trustee to sell [Couple 2’s] 50% interest in the LLC to [Male 1], and on September 14, 2015, the membership in the LLC was officially assigned to [Male 1].<sup>3</sup>

On April 14, 2016, [Male 1] renewed the LLC’s business license, indicating that the LLC owned real property in Washington and that there had been a transfer of a controlling interest. On April 21, 2016, the Department of Revenue’s Special Programs Division (“Special Programs”) wrote a letter to the LLC and to [Male 1] requesting completion of a controlling interest affidavit and payment of REET on the transfer. On May 19, 2016, [Male 1] submitted the affidavit with a letter which claimed the transfer was exempt from REET based on Attorney General Opinion 1953 No. 124 of August 28, 1953.<sup>4</sup> He also submitted documentation showing that the transfer of interest in the LLC was made pursuant to bankruptcy proceedings.

Special Programs concluded that the transfer of the LLC was subject to REET, and on May 27, 2016, assessed \$ . . . on the transfer. The assessment [consisted] of \$ . . . in REET based on a property value of \$ . . . , \$ . . . in interest, \$ . . . in a twenty-percent delinquent penalty, and \$ . . . in assessment penalty.<sup>5</sup>

Initially, [Male 1] asserted that, because [Couple 2] contested the sale of their interest and the decision to conduct the auction was only approved by the bankruptcy court after a hearing where

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

<sup>2</sup> . . .

<sup>3</sup> The official document assigning the interest is titled “Assignment by Bankruptcy Trustee of Stock in a Professional Services Corporation and of Membership Interest in a LLC.”

<sup>4</sup> The arguments made by [Male 1] during the administrative review process did not include reliance on this Opinion.

<sup>5</sup> As correctly noted by [Male 1], RCW 82.45.100(2) provides that delinquent filing penalties imposed on REET shall be collectible from the seller only. In this case, Special Programs cannot collect the delinquent penalty from [Male 1], the purchaser, or the LLC.

the parties' competing interests were considered, the transfer was pursuant to a court ordered sale and exempt from REET under WAC 458-61A-208. [Male 1] presented additional, alternative arguments during the course of the administrative review process. [Male 1] argues that RCW 82.45.010(3)(e), which exempts, "[t]he partition of property by tenants in common by agreement or as the result of a court decree" from REET, applies in this case. [Male 1] also argues that the bankruptcy trustee, not [Couple 2], possessed the controlling interest at issue at the time of sale, and therefore, the sale in this case represents a "sale by the United States," and is exempt from REET pursuant to RCW 82.45.010(3)(n).

### ANALYSIS

RCW 82.45.060 imposes REET on the sale of real property in Washington measured by the selling price.<sup>6</sup> RCW 82.45.010(1) broadly and inclusively defines the term "sale" as "any conveyance, grant, assignment, quitclaim, or transfer of ownership of or to title to real property . . . or any estate or interest therein for a valuable consideration." RCW 82.45.010(2)(a) provides that the term also 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(3) provides a list of transactions that do not constitute a "sale" for purposes of the REET. As relevant here, this list includes:

(e) The partition of property by tenants in common by agreement or as the result of a court decree.

...

(j) Any transfer or conveyance made pursuant to a deed of trust or an order of sale by the court in any mortgage, deed of trust, or lien foreclosure proceeding or upon execution of a judgment, or deed in lieu of foreclosure to satisfy a mortgage or deed of trust.

...

(n) A sale by the United States, this state or any political subdivision thereof, or a municipal corporation of this State.

RCW 82.45.450 authorizes the Department of Revenue to adopt rules "for the effective administration of this chapter [Chapter 82.45]." These rules are found in Chapter 458-61A of the Washington Administrative Code. At the time of the transfer at issue in this case, WAC 458-61A-208 ("REET Rule 208") provided as follows, in pertinent part:<sup>7</sup>

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<sup>6</sup> RCW 82.45.030 defines "selling price" for sales of controlling interest as "the true and fair value of the real property owned by the entity and located in this state."

<sup>7</sup> [Male 1] correctly notes that Rule 208 was amended effective October 27, 2016. As correctly noted by [Male 1], the amendments clarify that the exemption provided in RCW 82.45.010(3)(j) is limited to transfers in mortgage, deed of trust, or lien foreclosure proceedings. See REET Rule 208(4)(c), as amended, Example 1.

(1) **Introduction.** The real estate excise tax does not apply to any transfer or conveyance made pursuant to an order of sale by a court in any mortgage or lien foreclosure proceeding or upon execution of a judgment. Real estate excise tax affidavits which state claims for this tax exemption must cite the cause number of the foreclosure proceeding on the affidavit and the conveyance document. A copy of the court decision must be attached to the department's affidavit copy by the county treasurer.

(2) **Examples.** The following examples, while not exhaustive, illustrate some of the circumstances in which a transfer may or may not qualify for this exemption. These examples should be used only as a general guide. The taxability of each transaction must be determined after a review of all the facts and circumstances.

(a) Joan and Sam are friends. They decide to jointly purchase real property worth \$100,000 as tenants in common. One year later, they decide to end their co-ownership of the property. Joan and Sam cannot agree on how the property should be divided. They both obtain legal counsel and go to court to resolve the issue. The court orders that Sam will deed his interest in the real property to Joan and Sam will be paid \$65,000 for his interest in the property. No real estate excise tax is due on the transfer since the transfer is pursuant to a court ordered sale.

(b) Rather than going to trial, Joan and Sam agree to a settlement during the course of their negotiations. The attorneys draft an agreeable settlement under which Sam will get the property and Joan will be paid \$75,000. The settlement agreement is presented to the court and the judge signs off on the agreement. Tax is due on the transfer because this is not a court ordered sale.

(Emphasis added.) . . .

As stated, [Male 1's] initial argument regarding the controlling interest sale at issue was that it was exempt from the definition of "sale" pursuant to REET Rule 208. More specifically, [Male 1] argued that the sale in this case is akin to the example provided by REET Rule 208(2)(a). [Male 1] acknowledges that the controlling interest sale at issue does not fall within the ambit of the exemption provided by current REET Rule 208. Nonetheless, [Male 1] argues that REET Rule 208(2)(a), as it existed at the time of the sale, exempted the controlling interest sale at issue from REET.

[Male 1's] reliance on the example in former REET Rule 208(2)(a) misses the mark. [First, the example involves two friends who are tenants in common and subsequently go to court to divide the property between them. That example falls squarely within the statutory exemption for a "partition of property by tenants in common" by agreement or as a result of a court decree. RCW 82.45.010(3)(e). But, as discussed below, because this case does not involve tenants in common who are dividing their property interest, the example is inapplicable here. Second, the] exemption from REET carved out by RCW 82.45.010(3)(j) is quite narrow. It applies only to transfers or conveyances made "pursuant to a deed of trust or an order of sale by the court in any mortgage, deed of trust, or lien foreclosure proceeding or upon execution of a judgment, or deed in lieu of foreclosure to satisfy a mortgage or deed of trust." The transfer in this case was

unrelated to a mortgage, deed of trust, or lien foreclosure proceeding. The transfer in this case was also not the result of an “execution of a judgment.” [The controlling interest sale in this case arose from a court approved auction conducted by a trustee in bankruptcy proceedings. Even if] any similarities exist between sales upon “execution of a judgment” and the controlling interest sale in this case, they are not the same, and a narrow construction of RCW 82.45.010(3)(j) prevents its application in this case. The example in former REET Rule 208(2)(a) cannot expand the scope of the exemption provided in RCW 82.45.010(3)(j) beyond that which is provided by its plain language. [See *Coast Pacific Trading, Inc. v. Dep’t of Revenue*, 105 Wn.2d 912, 917-18, 719 P.2d 541 (1986) (rejecting Department’s expansion of statutory tax exemption by administrative rule).]

In fact, the amendments to REET Rule 208 noted by [Male 1] resulted from the [example in] former REET Rule 208(2)(a), [which could be interpreted in a manner] inconsistent with RCW 82.45.010(3)(j). In adopting the relevant amendments, the Department stated that their purpose was to: 1) “[r]eflect a 2015 Washington state court of appeals decision holding that a sale by a receiver in a receivership proceeding did not qualify for an exemption from [REET] as a sale made ‘upon execution of a judgment’”; and 2) “[r]emove an example that made it seem like all court-ordered sales were exempt from REET, which is an exemption not provided in the RCW[.]” WSR 16-20-016 (filed 9/26/2016).<sup>8</sup> Accordingly, the example in REET Rule 208(2)(a) does not provide a basis for exemption in this case.

[Male 1’s] next argument pertains to the exemption from REET created by RCW 82.45.010(3)(e). [Male 1] argues that the bankruptcy auction of the debtor’s interest in the property at issue “was the equivalent of a partition action.” However, as with the exemption in RCW 82.45.010(3)(j), the exemption in subsection (e) is narrow. It applies to “[t]he partition of property by tenants in common by agreement or as the result of a court decree.” The Department’s rule implementing this exemption further defines this exemption. It states, in relevant part, “[a] partition results when tenants in common agree that certain tenants will be assigned particular tracts within the property that they own together.” WAC 458-61A-204(2) (“REET Rule 204”).

[Male 1] and [Couple 2] did not own the relevant property as tenants in common. Instead, they held membership interests in the LLC that owned the property. This fact alone forecloses application of the exemption provided in RCW 82.45.010(3)(e) and REET Rule 204. Without a tenancy in common, there could be no “partition of property by tenants in common” and no agreement that “certain tenants will be assigned particular tracts within the property they own together.” Accordingly, the plain language of RCW 82.45.010(3)(e) and REET Rule 204 prevent the application of this particular exemption in this case.

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<sup>8</sup> The Court of Appeals case referred to is *Washington State Dept. of Revenue v. Federal Deposit Ins. Corp.*, 190 Wn. App 150, 359 P.3d 913 (2015). In this case, the Washington court of appeals considered the application of the phrase “upon execution of a judgment” in RCW 82.45.010(3)(j) to a sale of real property where a receiver was appointed by the court to “give effect to the judgment” pursuant to RCW 7.60.025. In concluding that this exemption did not apply, the court found that the phrase “upon execution of a judgment . . . clearly refers to the statutes governing the execution of judgments – chapter 6.17 RCW, ‘Executions,’ and chapter 6.21 RCW, ‘Sales under execution[.]’” The court’s narrow reading of the exemption provided in RCW 82.45.010(3)(j) lends further support for a narrow application to the facts of this case.

Finally, [Male 1] argues that the controlling interest sale in this case falls under the exemption contained in RCW 82.45.010(3)(n) pertaining to sales “by the United States.” He bases this argument on the fact that at the time of the controlling interest sale, the Bankruptcy Trustee, “acting in his capacity as an agent of the federal government,” held the [Couple 2’s] interest in the LLC. [Male 1] provides no citations to support the proposition that property included within the bankruptcy estate becomes the property of the United States government such that its distribution becomes a sale “by the United States.” Furthermore, Taxpayer’s argument conflicts with the definition of seller in RCW 82.45.020. Pursuant to this [statute], “trustee[s] in bankruptcy” are explicitly included within the definition of a “seller,” whereas, the “United States” is explicitly excluded. To accept [Male 1’s] position would be to ignore the distinction drawn by the legislature between sales by trustees in bankruptcy proceedings, upon whom REET may be assessed, and the United States, upon which the REET may not be assessed.

In summary, the controlling interest sale does not fall within any of the statutory exemptions claimed by [Male 1]. As such, we deny Taxpayer’s petition.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 9th day of February 2017.