

Cite as Det. No. 17-0251, 37 WTD 126 (2018)

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

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| 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. 17-0251 |
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| ... |) | Registration No. . . . |
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RCW 82.45.010(3)(p); WAC 458-61A-211: REAL ESTATE EXCISE TAX – MERE CHANGE IN IDENTITY OR FORM. A transfer of real property from one entity to another entity is not eligible for the mere change in identity or form exemption in RCW 82.45.010(3)(p) and WAC 458-61A-211 when the transfer results in the grantee owners not owning the property in the same pro rata shares as the grantor owners held prior to the transfer.

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.

Sattelberg, T.R.O. – A limited liability company (“Taxpayer”) protests the Department of Revenue’s (“Department”) assessment of real estate excise tax (“REET”) on its transfers of real properties to another limited liability company. Taxpayer argues that the transfers were exempt as mere changes in identity or form. We deny the petition.¹

ISSUE

Whether Taxpayer’s transfers of real properties to a second entity, owned 50 percent by Taxpayer and 50 percent by other parties, qualifies for the mere change in identity or form exemption from REET under RCW 82.45.010(3)(p) and WAC 458-61A-211.

FINDINGS OF FACT

Taxpayer acquired three residential properties (“Properties”) in . . . Washington, on April 20, 2012.² Taxpayer is owned 100 percent by . . .³ On January 16, 2015, Taxpayer transferred the Properties to . . . (“Related Entity”), via quit claim deed.⁴ Related Entity is owned 50 percent by Taxpayer, 25 percent by . . . , and 25 percent by . . .⁵ On the REET Affidavits filed with . . .

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

² The three properties are located [in Washington].

³ Taxpayer was formed on February 8, 2005, according to the Washington Secretary of State.

⁴ [Related Entity], was formed on February 6, 2013, according to the Washington Secretary of State.

⁵ The . . . and the . . . are not related.

County, Taxpayer claimed the transfer of the Properties were exempt from REET as mere changes in identity or form under WAC 458-61A-211.⁶

On September 22, 2016, the Department's Special Programs Division ("Special Programs") sent Taxpayer a notice that it was auditing Taxpayer's transfers of the Properties. The notice requested Taxpayer submit additional documentation to substantiate the exemptions by October 7, 2016. On October 10, 2016, Special Programs mailed Taxpayer a second letter stating this was its final request for documentation. The letter stated Taxpayer could either provide the additional documentation requested in the September 22, 2016, letter, or request an extension by October 24, 2016. On October 20, 2016, . . . provided Special Programs the operating agreement for Related Entity and its Internal Revenue Service Form 1065 [U.S. Return of Partnership Income] tax return for 2015.⁷ The tax return reported income and expenses from the Properties. Special Programs examined the additional documentation but determined that it did not substantiate the mere change in identity or form exemptions as claimed. On November 4, 2016, Special Programs issued Taxpayer a REET assessment of \$

Taxpayer paid the assessment and timely applied for refund. Taxpayer argues the Department should consider the transfers exempt as mere changes in form because the substance indicates it was the intent of the parties to have the Properties owned by Related Entity from the time of their initial purchase.⁸ To support its argument, Taxpayer provided the closing statements for each of the Properties showing that Taxpayer purchased the Properties on April 20, 2012. Taxpayer provided the Internal Revenue Service Form 1065 for 2012 for Related Entity. The 2012 Form 1065, like the 2015 version above, also reported income and expenses from the Properties. This was prior to the 2015 transfer of the Properties to Related Entity. Taxpayer argues this shows the intent of the parties was to have Related Entity own the Properties all along. Taxpayer also claims the Internal Revenue Service Form 1065s for 2013 and 2014 for Related Entity also show Related Entity claimed income and expenses from the Properties as well.

ANALYSIS

REET is imposed on each sale of real property in this state. RCW 82.45.060. The term "sale" includes "any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property . . . for a valuable consideration." RCW 82.45.010(1). Taxpayer does not dispute that ownership of the Properties changed from 100 percent owned by Taxpayer before the transfers to 50 percent owned by Taxpayer after the transfers.

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 addresses the mere change in identity or form of ownership of an entity exemption, providing the following:

⁶ The REET Affidavit for the . . . property did not have an exemption section filled in like the . . . properties, which both claimed exemption under WAC 458-61A-211(2)(f).

⁷ . . . stated in his October 20, 2016, e-mail that "we didn't think anything of it [that the properties were owned by [Taxpayer], and not [Related Entity]] until we realized in 2015 it was still under [Taxpayer] and would be good housekeeping to put it under [Related Entity]."

⁸ Taxpayer does not argue the exemption it claimed on the REET Affidavits, WAC 458-61A-211(2)(f), applies on review.

(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.

(2) Qualified transactions. A mere change in form or identity where no change in beneficial ownership has occurred includes, but is not limited to:

. . .

(d) The transfer by a corporation, partnership or other entity of its interest in real property to another corporation, partnership, or other entity if the grantee owner(s) receives it *in the same pro rata shares as the grantor owner(s) held prior to the transfer*.

(Emphasis added). Therefore, when a transfer results in the grantee owners not owning the property in the same pro rata shares as the grantor owners held prior to the transfer, the exemption does not apply. We note that the burden of showing qualification for a tax benefit rests with the taxpayer. *Group Health Cooperative of Puget Sound, Inc. v. State Tax Comm'n*, 72 Wn.2d 422, 429, 422 P.2d 201 (1967). Thus, Taxpayers must prove they are entitled to the benefit. *Id.* Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932).

Here, the Properties were owned 100 percent by Taxpayer before it transferred them to Related Entity. Related Entity is owned only 50 percent by Taxpayer. Thus, the transfers effectuated a 50 percent change in ownership, as . . . owned zero percent of the Properties prior to the transfers and 50 percent thereafter. Because the ownership percentages after the transfers were not in the same pro rata shares as the ownership percentages prior to the transfers, the mere change in identity or form exemption in RCW 82.45.010(3)(p) and WAC 458-61A-211 does not apply.

Taxpayer argues that the Department should disregard the quit claim deeds transferring the Properties, and instead focus on the fact that Related Entity reported the Properties for federal income tax purposes from 2012 through 2015. This reporting, Taxpayer argues, indicates the parties' intent that Related Entity own the Properties. We decline to accept this argument. While federal tax reporting can be indicative of intent of ownership, the actual ownership here was with Taxpayer prior to the transfers, as evidenced by the 2015 quit claim deeds. Additionally, the doctrine of substance over form is generally not available to a taxpayer to eliminate the tax consequences of the transaction. See *Washington Sav-Mor Oil Co. v. State Tax Comm'n*, 58 Wn.2d 518, 521, 364 P.2d 440 (1961); Det. No. 16-0089, 35 WTD 549 (2016). Here, Taxpayer purchased the Properties in its own name and later transferred them to Related Entity with a different pro rata share ownership. Had Related Entity initially purchased the Properties in 2012 instead of Taxpayer, there would not be the REET implications that resulted from the subsequent transfer from Taxpayer to Related Entity. However, Taxpayer was the owning entity here, and it chose to transfer the Properties to Related Entity in what is a REET taxable manner. We conclude Special Programs properly assessed REET on the transfers, and we deny Taxpayer's petition for refund.

DECISION AND DISPOSITION

We deny Taxpayer's petition for refund.

Dated this 20th day of October 2017.