

Cite as Det. No. 18-0284, 39 WTD 208 (2020)

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. 18-0284
)	
...)	Registration No. ...
)	

WAC 458-61A-102; RCW 82.45.030: REAL ESTATE EXCISE TAX – TRUE AND FAIR VALUE – ASSET ALLOCATION UNDER 26 U.S.C. § 1060 – SELLING PRICE. In a sale of real estate, when the true and fair value of the property at the time of sale cannot reasonably be determined by an allocation of assets under section 1060 of the Internal Revenue Code, the Department may rely on the market value assessment maintained in the county property tax rolls at the time of sale as the selling price for assessing real estate excise tax.

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.

Davis, T.R.O. – A Washington corporation (Taxpayer) seeks cancellation of an assessment of real estate excise tax (REET) imposed as the result of its sale of a business. Taxpayer objects to the Department’s use of the county market value property tax assessment as the selling price of the real property after Taxpayer provided an asset allocation made under IRC § 1060. Taxpayer asserts that the value determined under its IRC § 1060 asset allocation represents the true and fair value of the real property for the purpose of calculating REET, and therefore the Department is precluded from using the county market value property tax assessment for this purpose. We deny Taxpayer’s petition.¹

ISSUE

Under RCW 82.45.030, WAC 458-61A-101 (Rule 101), and WAC 458-61A-102 (Rule 102), does Taxpayer’s IRC § 1060 asset allocation reasonably determine the true and fair value of transferred real property, so the Department is precluded from relying on the property’s county market value property tax assessment?

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

FINDINGS OF FACT

. . . (Taxpayer) is a Washington corporation that previously engaged in the business of producing pulp and paper products at a mill located in . . . , Washington (Mill), as a subsidiary of the . . . group of companies.

On March 31, 2017, Taxpayer transferred ownership of the above business, including the Mill, . . . and all other related assets used in operating the mill (Business), plus a cash payment of \$. . . as partial offset of costs of assumed liabilities (Cash), to . . . (Buyer) in an asset purchase agreement (Agreement). In exchange for the Business and Cash, Buyer agreed to pay Taxpayer \$. . . (of which \$. . . was identified as the negotiated “purchase price” and \$. . . was prorated compensation for prepaid 2018 property taxes on the transferred property), and to assume certain outstanding Taxpayer liabilities (valued by the parties at \$. . . at the time of transfer). [“Purchase price” is defined to be \$. . . in cash, plus assumption of liabilities. *See* Agreement, Art. I, pg. 8.] The total consideration paid or transferred by Buyer to Taxpayer under the Agreement was \$²

Upon transfer, Taxpayer filed a real estate excise tax (REET) affidavit with the county assessor to document the change in ownership of real property in Washington. In the affidavit, Taxpayer reported a gross selling price of \$. . . , offset by an equivalent deduction for the value of personal property included in the sale [(including cash and cash equivalents, accounts receivable, prepaid expenses, and contracts, leases, permits, inventories, supplies, machinery, and equipment)], resulting in a reported taxable selling price of \$. . . and a total REET amount due of \$ [Ultimately, eleven parcels of real property, consisting of more than . . . acres of land, plus improvements including . . . other structures, were transferred by Taxpayer to Buyer in a deeded transfer recorded in . . . County effective . . . 2017. Special Programs determined that the market value assessment maintained on the . . . County property tax rolls at the time of the transfer for these real property parcels was \$]

Due to the nominal value reported in Taxpayer’s REET affidavit, on April 17, 2017, the Department’s Special Programs Division (Special Programs) began a REET audit of the transaction to determine the true and fair value of the transferred real property (Property) and calculate the correct amount of REET due, if any.

On June 6, 2017, Taxpayer sent Special Programs documentation describing an asset allocation made by the parties according to section 1060 of the Internal Revenue Code (1060 Allocation), under which the Property was allocated a value of \$³ In its accompanying letter, Taxpayer stated:

² As a condition of the transfer, Taxpayer also agreed to place \$. . . in an escrow account to be payable to Buyer contingent upon Buyer incurring agreed-upon capital expenditures, operating losses, decommissioning expenses, and acquisition costs related to the mill within four years of the transaction closing date. However, as Taxpayer also notes in written material provided to the Department, payment and receipt of these funds are contingent on Buyer’s future actions and thus unknown at the time of transfer. Because of the speculative nature of these amounts, we do not discuss them in detail here and they form no part of the legal analysis of this case.

³ The Internal Revenue Code requires the use of an asset allocation when there is an applicable transfer of a business or other group of assets made up of multiple asset classes. IRC § 1060(a) provides, “[i]n the case of any applicable asset acquisition . . . the consideration received for such assets shall be allocated among such assets . . . under section 338(b)(5). If . . . the transferee and transferor agree in writing as to the allocation of any consideration, or as to the fair

[T]he . . . Assets include much more than real property. . . . Therefore the total consideration clearly did not reflect the true and fair value of the real property contained in the . . . Assets, nor did the parties have a fair market appraisal prepared. Instead . . . the parties agreed to allocate the purchase price according to section 1060 of the Internal Revenue Code.

Letter from Taxpayer to Special Programs (June 6, 2017). Special Programs evaluated Taxpayer's 1060 Allocation and accompanying statements, but ultimately disagreed with Taxpayer's position. In its audit, Special Programs determined that neither the price paid nor Taxpayer's reported value in the REET affidavit accurately reflected the true and fair value of the Property, and, on August 24, 2017, the Department issued a REET assessment against Taxpayer for \$⁴ The Department's accompanying letter stated:

Per RCW 82.45.030, 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.

Because there was no fair market value appraisal, nor an allocation of assets pursuant to section 1060 of the Internal Revenue Code, we conclude from the information provided to us that the true and fair value of the real property owned by [Taxpayer] was \$ This is the . . . County assessed value for the real property transferred.⁵

On October 25, 2017, Taxpayer, having been granted a deadline extension, timely filed seeking review of the REET assessment.

Taxpayer requests cancellation of the assessment in its entirety, arguing that, under WAC 458-61A-102(19)(a), the parties' 1060 Allocation must be accepted by the Department as the true and fair value of the Property. Taxpayer asserts that, because a 1060 allocation was prepared by the parties, the Department is precluded from using the county real property market value assessment as a measure of taxable value under WAC 458-61A-102(19)(b).

Taxpayer provided additional information supporting the 1060 Allocation values on appeal. In its petition, Taxpayer provided a copy of the Agreement, but did not enclose Annex B thereto, described in the contents as "Allocation of Purchase Price." Taxpayer also provided a supplemental statement that included: 1) a copy of a separate spreadsheet showing the allocation

market value of any of the assets, such agreement shall be binding on both . . . unless . . . such allocation (or fair market value) is not appropriate." According to the same section, the purpose of a 1060 allocation is "determining both — 1) the transferee's basis . . . and 2) the gain or loss of the transferor with respect to [the] acquisition . . ." IRC § 1060(a) (2012). IRS Form 8594, Asset Acquisition Statement under Section 1060 (Form 8594), is the form used to prepare a 1060 allocation. The completed Form 8594 is submitted with the taxpayer's applicable federal income tax return.

⁴ The assessment consisted of \$. . . in state tax, \$. . . in local tax, \$. . . in interest, and a five percent tax assessment penalty of \$

⁵ Technically, a completed and filed 1060 allocation on Form 8594 and associated federal tax returns were not provided to the Department by Taxpayer. However, the terms of the Agreement make clear the intent of the parties was to value the assets using a 1060 allocation upon purchase, and Taxpayer provided documents and other evidence fully setting forth the information both parties calculated for use in their Forms 8594. We therefore accept Taxpayer's information as an "allocation of assets made under IRS § 1060" for the purpose of responding to Taxpayer's petition here.

values agreed to by the parties in the Agreement (“Trial Balance Report”); and 2) a copy of an allocation prepared by Buyer showing Buyer’s 1060 allocations (“Purchase Price Allocation Balance Sheet”). Taxpayer did not provide the Department with federal tax returns associated with the transaction, or a completed Form 8594.⁶

Taxpayer does not object to the Department’s calculations of tax, interest, and penalties, or to the accuracy of the county assessed value used. Instead, Taxpayer argues that, under WAC 458-61A-102(19), it prepared a valid 1060 Allocation and therefore the Department is precluded from using the county market value assessment as the selling price. According to Taxpayer, because the 1060 Allocation resulted in a real property asset value of \$. . . , no REET is due and the assessment should be cancelled.

ANALYSIS

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). REET is measured by the “selling price.” RCW 82.45.030; WAC 458-61A-101(4); WAC 458-61A-102(19).

At issue here is the determination of the selling price under RCW 82.45.030, WAC 458-61A-101(4), and WAC 458-61A-102(19). Taxpayer owned real property located in Washington at the time of the sale, and there is no dispute that a transfer occurred. Instead, Taxpayer challenges the amount Special Programs used as the “selling price” to calculate Taxpayer’s assessed REET liability. RCW 82.45.030 defines “selling price” as follows:

(1) As used in this chapter, the term “selling price” means the true and fair value of the property conveyed. If property has been conveyed in an arm's length transaction between unrelated persons for a valuable consideration, a rebuttable presumption exists that the selling price is equal to the total consideration paid or contracted to be paid

. . .

⁶ In its petition, Taxpayer summarizes the transferred asset value allocations by class according to IRS instructions, as follows:

Class I (cash and general deposits)	\$. . .
Class II (actively traded securities)	None
Class III (generally, accounts receivable)	\$. . .
Class IV (inventory)	\$. . .
Class V (all other assets, including real estate)	\$. . .
Class VI and VII (intangibles and goodwill)	\$. . .
Total	\$. . .

Under IRS 1060 allocation instructions in the Treasury Regulations, the total value allocated to the Property (a Class V asset) is \$. . . , because the full value of consideration paid is allocated to higher priority assets (Classes I and III) and none remains to allocate to lower priority Class V assets. *See* Treas. Reg. § 1.1060-1 (as amended in 2008).

(3) As used in this section, “total consideration paid or contracted to be paid” includes money or anything of value, paid or delivered or contracted to be paid or delivered in return for the sale, and shall include the amount of any lien, mortgage, contract indebtedness, or other encumbrance, either given to secure the purchase price, or any part thereof

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.) “True and fair value” is defined for the purposes of Chapter 458-61A WAC (REET) as “market value, which is the amount of money that a willing, but unobliged, buyer would pay a willing, but unobligated, owner for real property, taking into consideration all reasonable, possible uses of the property.” WAC 458-61A-101(2)(c) (emphasis added).

Total Consideration Paid

Here, there is no dispute that this was “an arm’s length transaction between unrelated persons.” However, Taxpayer has asserted that total consideration paid (\$. . .) is an inaccurate measure of the Property selling price, because the consideration paid by Buyer was for the purchase of the Business, including a group of many different assets of multiple classes, of which the Property is only a part. *See* Letter from Taxpayer to Special Programs (June 6, 2017).

We agree with Taxpayer’s evaluation. As in this case, where real property forms only part of the purchase and sale of an entire business, the total consideration paid for the business cannot reasonably determine the property’s true and fair value under RCW 82.45.030(1). *See McFreeze Corp. v. Dep’t of Revenue*, 102 Wn. App. 196, 201, 6 P.3d 1187 (2000). *See also* Det. No. 98-083, 17 WTD 271 (1998) (tax on real estate transferred in sale of an LLC is based on the value of the real estate, not the entire business); Det. No. 10-0175, 30 WTD 54 (2011) (REET due on total value of real property conveyed, not funds received for business interest conveyed).

WAC 458-61A-102(19) provides more specific requirements for determining selling price:

“Selling price” means the true and fair value of the property conveyed. There is a rebuttable presumption that the true and fair value is equal to the total consideration paid or contracted to be paid to the seller or to another person for the seller's benefit.

- (a) When the price paid does not accurately reflect the true and fair value of the property, one of the following methods may be used to determine the true and fair value:
 - (i) A fair market appraisal of the property; or
 - (ii) An allocation of assets by the seller and the buyer made under section 1060 of the Internal Revenue Code

- (b) When the true and fair value of the property at the time of sale cannot reasonably be determined by either of the methods in (a) of this subsection, the market value assessment for the property maintained in the county property tax rolls at the time of sale will be used as the selling price. RCW 82.45.030.

(Emphasis added.) Having concluded that total consideration was not the true and fair value, we look to alternative methods of determining true and fair value. Here the parties did not perform a fair market appraisal of the Property under WAC 458-61A-102(19)(a)(i). Instead, Taxpayer provided a 1060 Allocation under WAC 458-61A-102(19)(a)(ii) as the basis for the Property's true and fair value. We next review whether the 1060 Allocation is a reasonable determination of the Property's true and fair value.

1060 Allocation

When certain assets are sold, the IRS requires each party to the sale to allocate the sales price among the different assets sold or acquired according to a formula. *See* IRC § 1060. The formula has been described generally as follows:

The goal in enacting Code Sec. 1060 was to allocate purchase price in a rational economic manner, based on the so-called "residual method." The residual method is nothing more complex than a set of rules whereby the aggregate purchase price of a business is allocated in a logical economic progression, from the most easily valued assets (cash being the most easy-to-value asset), and descending in order of valuation ease until the remaining amount (the so-called "residual amount") is allocated to the assets with the most difficult and imponderable value, namely business goodwill.

Joseph B. Darby III, *Practical Guide to Mergers, Acquisitions and Business Sales*, CCH, 340.01 (2006).

The formula limits the maximum consideration that can be allocated to tangible assets to their fair market value. *See* IRC § 1060. Under the residual method, the amount of consideration allocated to each tangible asset can, however, be less than its fair market value when the total consideration for the sale is less than the individual fair market value of each asset. *See, e.g.*, Darby at 340.04 ("The result of the residual method is that the portion of the purchase price not allocated to [tangible assets] is allocated to the [goodwill and going concern value]"). Accordingly, allocations under IRC § 1060 may not be persuasive evidence of the fair market value of an asset. That appears to be the case here. After the parties allocated consideration to the easily and accurately valued cash assets under Class I, and all remaining residual consideration was allocated to accounts receivable under Class III, no consideration remained for allocation to inventory (Class IV), real estate (Class V), or goodwill and going concern value (Class VII). The allocated residual value of the Property was therefore \$

Washington law requires property to be valued at one hundred percent of its true and fair value, which means "fair market value." *See Tiger Oil Corp. v. Yakima County*, 158 Wn. App. 553, 563, 242 P.3d 936, 941 (2010); *Washington Beef, Inc. v. County of Yakima*, 143 Wn. App. 165, 177 P.3d 162 (2008) (*citing* RCW 84.40.030). This is why both the statute and administrative rules

default to the county assessor's property tax valuation when the true and fair value of the property cannot reasonably be determined by other methods. Taxpayer argues that the value determined by the 1060 Allocation represents the true and fair value of the property. We disagree.

As stated earlier, under WAC 458-61A-101(2)(c), "true and fair value" is defined as "market value. Under WAC 458-61A-101(2)(c), when determining a property's market value, "all reasonable, possible uses of the property" must be taken into consideration. Current or past actual uses are therefore not determinative under this analysis. Here, the Property consists of ...parcels totaling significantly more than ... acres of land. Several of the parcels contain significant improvements, such as ...and other business structures. The Property is primarily located on or near the city's downtown waterfront. Each of these facts indicates potential value. Although it is impossible to determine the full range of uses that could conceivably be made of such parcels of real estate, or to know the actual amount that an arm's length sale of each parcel might theoretically bring, here the facts available in the record suggest the Property's market value is some amount greater than zero. This means the \$. . . consideration allocated to the Property under the residual method of IRC 1060 cannot be the true and fair value of the Property.

Summary

WAC 458-61A-101(4) and WAC 458-61A-102(19) first look to whether the true and fair value of the properties can reasonably be determined based upon the total consideration paid. We find that this is not a reasonable method of determining the Property's true and fair value because the consideration was paid to purchase the Business, not paid for the Property alone, and the Business consisted of more than real property. Next, under WAC 458-61A-101(4)(a) and WAC 458-61A-102(19)(a), two alternative options (i) and (ii) "may" be used if the true and fair value cannot reasonably be determined.

Here a fair market value appraisal of the property was not done, so (i) does not apply. Taxpayer did provide an allocation of assets under IRC § 1060 consistent with (ii), but because no residual consideration was available to allocate to the Property under Class V, the factual characteristics of the Property suggest a fair market value greater than zero, we conclude that the 1060 Allocation here does not reasonably represent the true and fair value of the Property.

Therefore, under RCW 82.45.030(4), WAC 458-61A-101(4)(b), and WAC 458-61A-102(19)(b), Special Programs properly measured REET using the market value assessment for the property maintained on the county property tax rolls at the time of the sale. We deny Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 24th day of October 2018.