

Cite as Det. No. 20-0097, 41 WTD 67 (2022)

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. 20-0097
)	
...)	Registration No. . . .
)	

WAC 458-61A-208; RCW 82.45.010: REAL ESTATE EXCISE TAX – EXEMPTIONS – EXECUTION OF A JUDGMENT. The transfer of a controlling interest in a limited liability company that holds real property was not exempt from REET as an execution of a judgment where the transfer was made pursuant to a settlement agreement.

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.

Ryan A. Johnson, T.R.O. – A limited liability company that owns property in Washington protests the assessment of real estate excise tax (“REET”) on one of its members’ acquisition of a controlling interest in the company. It asserts: that the transfer was exempt from REET under RCW 82.45.010(3)(j) and WAC 458-61A-208(5) as an execution of a judgment, that there was no sale price upon which to assess REET, and that there was no consideration. We conclude that REET is due on the transfer. The taxpayer’s petition is denied.¹

ISSUE

Whether REET is due under RCW 82.45.010 on the transfer of a controlling interest in a limited liability company from one member to another, where the members negotiated that the acquiring member would release the other from responsibility for the company’s liabilities.

FINDINGS OF FACT

. . . (“Taxpayer”) owns [property where it] operates a retail [business] (the “Property”). Taxpayer was formed in 2010 by . . . (“Transferee”) and . . . (“Transferor”), each having an equal 50% ownership interest. Within the first few years of operation, Transferee and Transferor began to disagree regarding how to run Taxpayer. They unsuccessfully attempted to resolve their differences through counseling and arbitration before Transferee eventually filed suit in . . . 2014 in . . . superior court against Transferor on behalf of . . . himself and Taxpayer.

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

After litigating the matter for more than three years, the parties stipulated to an agreed order (the “Agreement”), which was [approved by the court] Therein, the parties agreed to place Taxpayer, together with another company mutually owned by Transferee and Transferor (collectively, the “Companies”), for sale on the open market. Under the Agreement, if certain conditions were not met in regard to the sale, either party would have the opportunity to submit proposals to acquire the other’s ownership interest in and take control of the Companies. To do so, either party would have to negotiate with a bank that held [the] promissory notes owed by the Companies (the “Debt”), to both assume full responsibility for the Debt and to release the other party from any personal guarantees associated with the Debt. Transferee negotiated with the bank and, in accordance with the Agreement, successfully acquired Transferor’s shares in the Companies.

Transferor objected to the manner in which Transferee acquired its shares in the Companies and moved for the court to intervene. The judge heard oral arguments on Transferor’s motion . . . [where] Transferee’s attorney characterized the Agreement as a settlement between the parties. . . . Transferor stated . . . that Transferee had already filed documents with the Secretary of State to remove him as a member of Taxpayer. . . . It was repeatedly mentioned during the hearing that while Transferee was negotiating with the bank to assume the Debt, he was simultaneously seeking financing from another financial institution to purchase the Companies for the amount of the Debt pursuant to the Agreement. . . .

At the conclusion of the hearing, the judge ordered [that Transferee now owns the debts and assets of the Companies because Transferee invoked the clause in Agreement to assume sole responsibility for the Companies].

The judge also ordered the Transferee to [release the Transferor from Debt and all of the Companies’ liabilities.] The judge thereafter memorialized these statements in a written order . . . (the “Order”).

Taxpayer filed its annual report with the Washington Secretary of State [for] 2018. The annual report indicated through Taxpayer’s required responses that Taxpayer owned real property in this state and that an ownership interest in Taxpayer of 50% or more had been transferred in the prior 12 months. The Department became aware of this information and contacted Taxpayer via letter on July 23, 2019, then again on August 13, 2019, to inquire about the transfer of ownership. Therein, the Department also requested that Taxpayer complete and submit a REET affidavit regarding the details of the transfer.

Taxpayer completed a REET affidavit and submitted it to the Department. In the affidavit, Taxpayer claimed that the transfer of ownership is exempt from REET under WAC 458-61A-208(5) as [a transfer pursuant to] an execution of a judgment. Taxpayer stated that the transfer was part of a judgment entered by . . . superior court and memorialized in the Order. The Department requested a copy of the Order, which Taxpayer provided.

After reviewing the REET affidavit and the Order, the Department issued a REET assessment (“Assessment”) against Taxpayer in the amount of \$. . . . The value of the Assessment comprised \$. . . of REET, penalties of \$. . . and interest of \$. . . . In a letter accompanying the Assessment,

the Department explained that it calculated the REET based upon \$. . . , the market value assessment of the Property maintained on the county property tax rolls at the time Transferor released his interest in Taxpayer to Transferee. Without paying, Taxpayer timely filed a petition for review of the Assessment.

Taxpayer asserts that Transferor's release of ownership was exempt from REET under RCW 82.45.010(3)(j) and WAC 458-61A-208(5) as [a transfer pursuant to] an execution of a judgment. Taxpayer acknowledges that none of the examples set forth in WAC 458-61A-208(5) encapsulates the circumstances at issue in this matter, but asserts that REET was not intended to apply to such circumstances and that the release of ownership was put into effect by the Order.

Taxpayer also asserts that there was no consideration exchanged in Transferor's release to Transferee of its 50% interest in Taxpayer because there was no sale price² and it did not put either Taxpayer or Transferee in a better position because ownership of the Property remained with Taxpayer, irrespective of Transferor or Transferee's ownership shares. Therefore, Taxpayer asserts, the measure of REET should have been \$0.

ANALYSIS

REET is imposed upon the sale of real property in Washington, unless the transaction is exempt therefrom. 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(22). Sales, for purpose of REET, include the transfer of a controlling interest in an entity that has an interest in real property in this state. RCW 82.45.030(2); WAC 458-61A-101(1). "Controlling interest" of an LLC means 50% or more of the beneficial interest in the entity. RCW 82.45.033; WAC 458-61A-101(2)(a)(ii).¹

Here, we must first determine whether the release of Transferor's interest in Taxpayer is subject to REET. If it is, we next determine if an exemption applies. If it is not exempt, we must determine the proper measure of the selling price under RCW 82.45.030.

Taxpayer owned real property located in Washington at the time of Transferor's release of his interest to Transferee, and that transfer involved a controlling interest of Taxpayer because Transferor released his entire 50% ownership interest. Accordingly, the release constitutes a "sale" that is subject to REET. RCW 82.45.030(2); WAC 458-61A-101(1). Next, we examine whether an exemption applies.

There are certain transfers of a controlling interest in an entity that holds an interest in real property that are exempt from the application of REET. *See* RCW 82.45.010(3). One such exempt type of transfer, set forth in RCW 82.45.010(3)(j), is 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

² Taxpayer also asserts, hypothetically, that if Transferor had paid Transferee for his shares, such payment would have been for half of the business, rather than the total value of the property.

trust.” Here, Taxpayer asserts that the controlling interest transfer was made upon execution of a judgment, and, thus, is exempt from tax.

WAC 458-61A-208 is the Department’s administrative rule implementing the exemption in RCW 82.45.010(3)(j). It reads in relevant part:

(5) Execution of a judgment.

(a) Sheriff’s sale. The real estate excise tax does not apply to a transfer of real property made upon execution of a judgment under chapters 6.17 (dealing with executions of a judgment) and 6.21 RCW (dealing with sales made due to an execution of a judgment, known generally as sheriff’s sales), **which refers to a writ of execution by the court ordering a sale of real property by a county sheriff.** A real estate excise tax affidavit must be filed with the county, and a copy of the writ of execution must be available and provided to the county treasurer or department on request.

(Emphasis added.)

Taxpayer asserts that Transferor’s release of ownership was exempt from REET as an execution of a judgment under RCW 82.45.010(3)(j) and WAC 458-61A-208(5). However, that exemption does not apply to the facts in this matter. WAC 458-61A-208(5)(a) explains that the language “execution of a judgment” in RCW 82.45.010(3)(j) pertains to transfers of real property that occur through “a writ of execution by the court ordering a sale of real property by a county sheriff.” Such a transfer is not present here. The facts in this matter involve neither a writ of execution nor a sheriff’s sale. Here, the transfer at issue, Transferee’s acquisition of Transferor’s controlling interest in Taxpayer, occurred pursuant to the negotiated terms of an agreement between them. Accordingly, we cannot conclude that the transfer was exempt under RCW 82.45.010(3)(j) and WAC 458-61A-208(5).

Finally, we focus our attention on the determination of the selling price under RCW 82.45.030. Taxpayer challenges the amount the Department used as the “selling price” to calculate Taxpayer’s assessed REET liability. RCW 82.45.030 defines “selling price” as follows:

(1) As used [for REET purposes], 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

(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.

(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 will be used as the selling price.

(Emphasis added); *see also* WAC 458-61A-101(4). “True and fair value” is the “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).

In the transfer of the controlling interest in an entity that holds an interest in real property, the measure of REET is not the consideration paid for that controlling interest, but the true and fair value of the real property owned by the entity. RCW 82.45.030(2); *see also* *McFreeze Corp. v. Dep’t of Revenue*, 102 Wn. App. 196, 201, 6 P.3d 1187 (2000); 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 business); Det. No. 10-0175, 30 WTD 54 (2011) (REET is due on total value of real property conveyed, not funds received for business interest conveyed). Here, such property is the land and building

Taxpayer asserts, the measure of REET should be \$0 because the transfer was a release of a business interest as opposed to a standard market sale, and the ownership of the Property remained with Taxpayer, irrespective of Transferor or Transferee’s ownership shares. [The fact that] the transfer at issue is [not] a deeded transfer is irrelevant to our analysis, as RCW 82.45.030(2) includes transfers of controlling interests in the definition of “sale.” *See also* WAC 458-61A-101. Here, the proper basis for REET is the true and fair value of the Property at the time Transferor released its interest in Taxpayer, not the true and fair value of the interest released. RCW 82.45.030; *McFreeze*, 102 Wn. App. At 201.

Because Taxpayer has not provided an independent appraisal of the Property or other basis to reasonably determine its fair market value, we are directed by RCW 82.45.030(4) to use as the basis for calculating REET the market value assessment for the Property maintained on the county property tax rolls at the time of the transfer. Accordingly, we find that the Department properly measured REET by calculating it in this manner.

Taxpayer finally asserts that there was no consideration exchanged in Transferor’s release. However, Taxpayer’s attorney stated differently in the course of its superior court case when he stated [that the release was consideration for the shares]. We agree with Taxpayer’s attorney. In the REET context, consideration includes “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” RCW 82.45.030(3). In exchange for Transferee’s acquisition of Transferor’s shares in Taxpayer, Transferor received debt relief as he was released from responsibility for any of Taxpayer’s liabilities. . . . Such consideration was negotiated between Transferee and Transferor in the Agreement.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 24th day of March 2020.