

Cite as Det. No. 14-0005R, 33 WTD 583 (2014)

BEFORE THE APPEALS 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>
Correction of Assessments of)	
)	No. 14-0005R
)	
...)	Registration No.,
..., and)	..., & ...
)	
...)	
)	

[1] RCW 82.45.030(1): REAL ESTATE EXCISE TAX – NONRECOURSE DEBT – TRANSFEROR’S BENEFIT. Payments the buyer of real property makes on the seller’s nonrecourse mortgage loan are a benefit to the seller.

[2] WAC 458-61A-103(2): REAL ESTATE EXCISE TAX – EXCLUSION OF NONRECOURSE DEBT FROM PURCHASE PRICE – The amount of a nonrecourse mortgage loan remaining unpaid at the time of sale of real property may not be excluded from the purchase price for REET calculation purposes, when the seller gives other consideration for the purchase.

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.

Munger, A.L.J. – Three LLCs that transferred real property for consideration that included the grantees taking the property subject to non-recourse mortgages, petition for reconsideration of a determination sustaining REET (Real Estate Excise Tax) assessed on the non-recourse debt included in the sales price. Because the WAC 458-61A-103(2) REET exemption applies only to transfers involving solely non-recourse debt, and no other consideration, we affirm the assessment of additional REET.¹

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

ISSUES²

1. Whether payments made by the real property's buyer on the Taxpayers' nonrecourse debt were consideration paid to another for the transferor's benefit under RCW 82.45.030(1).
2. Whether the measure of the REET under WAC 458-61A-103(2) is the amount of the full consideration, or whether it excludes the amount of nonrecourse debt remaining on the property sold at the time of sale.

FINDINGS OF FACT³

We are repeating the facts from Det. No. 14-0005 for the reader's convenience. In 2012, the Special Programs Division of the Department of Revenue (the Department) reviewed several REET affidavits regarding the transfer of property owned by three related taxpayers to three grantees. The taxpayers, which operate assisted living facilities, were [Taxpayer A], [Taxpayer B], and [Taxpayer C]. The taxpayers transferred their real properties to [Grantee A], [Grantee B], and [Grantee C] respectively (the grantees). The date of the three transfers was December 1, 2011. REET was paid on the amount of the consideration the taxpayers considered taxable, and two REET exemptions were claimed on the Real Estate Excise Tax Affidavits.

The Taxpayers and the Department ultimately agreed to the value of other personal and intangible property assets transferred, so that the only remaining issue on appeal relates to the REET, and the consideration for just the real estate portion of the various [. . .] transactions. The remaining exemption in dispute is the one claimed under WAC 458-61A-103(2) for nonrecourse debt.

After the Special Programs audit review was completed, the following three REET assessments were issued:

[Taxpayer A]

Based on the parties' Asset Purchase Agreement (APA) and Master Agreement, this taxpayer sold 80% of its real property together with associated personal and intangible properties to [Grantee A]. The assessed value of the property is \$. . . (per Independent Appraisal report) of which \$. . . was real property value and \$. . . was tangible and intangible personal property. The purchase price was \$. . . (per the APA, which also subtracted the outstanding mortgage balance or "Facility Term Debt" from the sales price). The Grantor reported and paid REET based on a selling price of \$. . . , which amount excluded the amount of nonrecourse debt on the property. Not under appeal is the 20% deduction that was allowed under WAC 458-61A-212, when there is a nonrecognition of gain or loss on contribution as per the IRC, Section 721. 80% of the \$. . . in nonrecourse debt on the property was \$. . . . Having disallowed the exemption under WAC 458-61A-103(2), the Department used this amount of \$. . . for an assessment of additional

² On reconsideration the Taxpayers also initially raised an issue relating to detrimental reliance on prior advice from the Department. On April 24, 2014, the Taxpayers confirmed that they were not proceeding with that issue on reconsideration. In prior discussions with the Taxpayers, the Department had also not been persuaded that this issue would have provided any relief on reconsideration, so we will not address it further here.

³ We will not discuss here the various business asset valuation issues resolved by the parties before the issuance of the revised assessments before us on appeal, and on reconsideration.

REET. With interest and the assessment penalty, the total was \$. . . when the final assessment was issued December 10, 2012.

[Taxpayer B]

Based on the parties' Asset Purchase Agreement and Master Agreement, this taxpayer sold 80% of its real property together with associated personal and intangible properties to [Grantee B]. The assessed value of the property is \$. . . (per Independent Appraisal report) of which \$. . . was real property value and \$. . . was tangible and intangible personal property. The purchase price was \$. . . (per the APA, which also subtracted the outstanding mortgage balance or "Facility Term Debt" from the sales price). The Grantor reported and paid REET based on a selling price of \$. . . , which excluded the amount of nonrecourse debt on the property. Also not under appeal is the 20% deduction allowed under WAC 458-61A-212. 80% of the \$. . . in nonrecourse debt on the property was \$ Having disallowed the exemption under WAC 458-61A-103(2), the Department used this amount of \$. . . for an assessment of additional REET. With interest and the assessment penalty the total was \$. . . when the final assessment was issued December 10, 2012.

[Taxpayer C]

Based on the parties' Asset Purchase Agreement and Master Agreement, this taxpayer sold 80% of its real property together with associated personal and intangible properties to [Grantee C]. The assessed value of the property is \$. . . (per Independent Appraisal report) of which \$. . . was real property value and \$. . . was tangible and intangible personal property. The purchase price was \$. . . (per the APA, which also subtracted the outstanding mortgage balance or "Facility Term Debt" from the sales price). The Grantor reported and paid REET based on a selling price of \$. . . , which amount excluded the amount of nonrecourse debt on the property. Also not under appeal is the 20% deduction allowed under WAC 458-61A-212. 80% of the \$. . . in nonrecourse debt on the property was \$ Having disallowed the exemption under WAC 458-61A-103(2), the Department used this amount of \$. . . for an assessment of additional REET. With interest and the assessment penalty the total was \$. . . when the final assessment was issued December 10, 2012.

Associated with these three properties were the debt instruments that contained matching language, and were entitled "Multifamily Notes." Section 10(a) of the notes established that the debt was nonrecourse. However, Sections 10(b) & 10(c) listed limited circumstances under which the Taxpayer/borrowers could incur full or partial personal liability. These included engaging in unpermitted business activities, transfer of the properties amounting to a default, bankruptcy, and failure to pay over certain funds. The Taxpayers assert that these are standard default terms in the case of nonrecourse debt.

On December 1, 2011, the same date of these three transfers, Fannie Mae consented in writing to agreements for each of the three transactions whereby it agreed to the buyers' assumption of the sellers' (the Taxpayers') debt obligations on their mortgages from prior years. Each agreement was entitled: "Assumption and Release Agreement (Full Property and Loan Assumption) (Pre-2011 Loan Documents)." These three agreements noted that the debts were not in default. These assumptions had been planned as part of the parties' Master Agreement executed earlier on October 7, 2011.

The Taxpayers have not paid the additional REET assessed, and timely appealed.

ANALYSIS

Chapter 82.45 RCW imposes the real estate excise tax (REET) on the sale of real property in the State of Washington. The term “sale” has its ordinary meaning and includes any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property for valuable consideration. RCW 82.45.010(1). The REET imposed by RCW 82.45.060 is based on the selling price, and is the obligation of the seller. RCW 82.45.080.

RCW 82.45.030 defines “selling price”:

(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 to the transferor, or to another for the transferor's benefit.*

RCW 82.45.030 (emphasis added).

RCW 82.45.030(3) then defines consideration as follows:

(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 incumbrance*, either given to secure the purchase price, or any part thereof, *or remaining unpaid on such property at the time of sale.*

Id. (emphasis added). The term “consideration” is also defined in WAC 458-61A-102, in relevant part, as follows:

(2) "**Consideration**" means money or anything of value, either tangible or intangible, paid or delivered, or contracted to be paid or delivered, including performance of services, in return for the transfer of real property. The term includes the amount of any lien, mortgage, contract indebtedness, or other encumbrance, given to secure the purchase price, or any part thereof, *or remaining unpaid on the property at the time of sale.* For example, Lee purchases a home for \$250,000.00. He puts down \$50,000.00, and finances the balance of \$200,000.00. The full consideration paid for the house is \$250,000.00.

(b) "Consideration" includes the assumption of an underlying debt on the property by the buyer at the time of transfer. For example, Ben buys a residence, valued at \$300,000.00, from Liza. Liza was purchasing the property on a real estate contract that has an outstanding balance of \$175,000.00. Ben gives Liza \$125,000.00 in cash and he assumes the obligation on the real estate contract, which Liza assigns to him. Real estate excise tax is due on \$300,000.00, which is the total consideration for the sale.

WAC 458-61A-102 (emphasis added).

WAC 458-61A-102(2) above states the general rule that consideration includes the amount of any lien or mortgage remaining unpaid on the property at the time of sale. However, WAC 458-20-103 clarifies that consideration does not include debt for which the grantor has no personal liability. This type of debt is referred to as nonrecourse debt.⁴ WAC 458-61A-103⁵ states, in relevant part:

Transfers involving an underlying debt.

(1) **Introduction.** The real estate excise tax applies to transfers of real property when the grantee relieves the grantor from an underlying debt on the property or makes payments on the grantor's debt. The measure of the tax is the combined amount of the underlying debt on the property and any other consideration.

(2) **Transfers where grantor has no personal liability for the underlying debt.** Real estate excise tax does not apply to transfers of real property subject to an underlying debt when the grantor has no personal liability for the debt and receives no other consideration for the transfer.

For example, Yen purchases property with funds obtained from PSP Corporation and secured only by the property. Yen has no personal liability for this debt. If Yen fails to make payments on the debt, PSP may foreclose on the property but it may not obtain a judgment against Yen. Yen transfers the property to Lee subject to the underlying debt. Lee takes the property subject to the underlying debt, and does not give any other consideration for the property. If Lee fails to make payments, PSP may foreclose on the property but it may not obtain a judgment against Lee (who, like Yen before, has no personal liability for the debt). Because Yen is not personally liable for the debt, Lee's payments on the underlying debt to PSP do not relieve Yen of any liability for the debt. The real estate excise tax does not apply to this transfer because there is no consideration.

WAC 458-61A-103. The one example provided in WAC 458-61A-103(2) cited above presents a different fact pattern from the one in the present appeals. In each of the three cases before us now, there was other additional consideration (millions of dollars in each case) given beyond just assumption of the nonrecourse debt.

What the parties dispute again on reconsideration is the measure of the REET when applying the WAC 458-61A-103(2) exemption. The Department asserts that no REET exemption at all may be taken when other consideration is given, citing the “...and receives no other consideration for the transfer” language above. The Taxpayers assert that the amount of the nonrecourse debt is

⁴ The structure of a nonrecourse loan is that it acts to limit the lenders' rights in the event of a default. However, the lender retains the most valuable right, which is to foreclose on the encumbered property in the event of default.

⁵ The substantive language of WAC 458-61A-103(2) was previously codified as WAC 458-61-374(1), promulgated in 1994. WAC 458-61A-103 became effective December 17, 2005. This recodification did not materially alter the rule.

REET-exempt, whether or not other consideration was given. On reconsideration the Taxpayers emphasize the language in RCW 82.45.030(3) defining “selling price” as the total consideration including amounts paid “...to another for the transferor's benefit.” The Taxpayers argue that the taking over of the nonrecourse debt by the buyer was of no benefit to the sellers, because the sellers had no personal liability on the debt.⁶

1. The Transferor's Benefit

As the above cited statutory structure for the REET sets forth, REET is assessed as follows:

- The REET is based on the property's sale price. RCW 82.45.060.
- The selling price is the true and fair value of the property sold. RCW 82.45.030(1).
- With an arm's length transaction, we presume the selling price is the total consideration paid to the seller, or to another for the seller's benefit. RCW 82.45.030(3).
- Consideration includes money or anything of value, paid or contracted to be paid in return for the sale, and includes the amount of “...any lien, mortgage, contract indebtedness, or other incumbrance...” securing the purchase price, or remaining unpaid on the property at the time of sale. RCW 82.45.030(3).

Turning to the present case, it is clear that deducting the three nonrecourse loans in this case would be contrary to the first principle of assessing REET, that it be based on the value of the property. Deducting these loans would have reduced the taxable values to tens of millions below the fair values of the properties. RCW 82.45.060. Secondly, nonrecourse loans are “...any lien, mortgage, contract indebtedness, or other incumbrance...” The statutory requirement that these amounts be included in the consideration makes no distinction as to what type of loan or lien; it just states “any.” RCW 82.45.030(3).

This leads to the . . . “transferor's benefit” issue, briefed on reconsideration, that we did not address in detail in our previous determination. Again, the context of this term is from the statutory phrase: “...total consideration paid or contracted to be paid to the transferor, or to another for the transferor's benefit...” RCW 82.45.030(3). In this regard, the Taxpayers assert that the buyers' payments on the nonrecourse debt did not benefit the Taxpayers because the Taxpayers had no personal liability on the debt. The Taxpayers also point out that we did not cite any benefit received by the Taxpayers from the assumption of the nonrecourse debt in our prior determination. We now examine the effect of the assumption of the nonrecourse debt in the present case.

Prior to the three sales in this case:

- The sellers were making payments on loans with balances of \$. . . , \$. . . , and \$. . . respectively.⁷ The loans were not in default.

⁶ We have paraphrased the parties' contentions here.

⁷ Because of the Taxpayer's 20% interest, and the application of WAC 458-61A-212, the amounts subject to the REET were \$. . . , \$. . . , \$. . . respectively.

- The sellers were personally liable for the loan balances, in whole or in part in certain limited circumstances per Section 10 of the Multifamily Notes. We have no evidence of whether these terms are “standard”, but they did create some potential of personal liability in the event of certain types of default.

After the three sales in this case, the Taxpayers were no longer making the payments on the three loans, and were relieved of any potential liability for the loan balances as well. The Taxpayers’ claim that they received no benefit from the above series of events is a bare assertion; they provided no facts to support it. The key facts are that the Taxpayers had been paying on millions in debts that they now no longer have to. This is obviously a major benefit.

Additionally, asserting that the Taxpayer’s had no liability under the nonrecourse loans is not entirely accurate. Section 4.(a) of the notes stated: “The primary obligation of the Borrower under this Note is to pay principal of, premium, if any, and interest on this Note...” The structure of the Taxpayer’s nonrecourse loan is that they acted to limit the lenders’ rights in the event of a default. (Section 10. “Limits on Personal Liability”) However, the lender retains the most valuable right, which is to foreclose on the encumbered property in the event of default. Had the Taxpayers defaulted they would have lost their property the same as if they had been personally liable on the notes. Factually, we find that being relieved of these obligations is a substantial benefit to the selling Taxpayers. Additionally, we find that the buyers’ payments on the loans were for the “transferor’s benefit” as that term is used in RCW 82.45.030(3). Consequently, we find that the inclusion of the unpaid nonrecourse debt was properly part of the consideration used to calculate the measure of the REET in these three sales.

2. No Other Consideration

In these three sales, in addition to the remaining unpaid nonrecourse debt, the buyers paid several million in additional consideration. We turn again to the issue raised by the language in WAC 458-61A-103(2) stating that the “*Real estate excise tax does not apply to transfers of real property subject to an underlying debt when the grantor has no personal liability for the debt and receives no other consideration for the transfer.*”

In Det. No. 97-240R, 21 WTD 145 (2002) we addressed some of the same issues present in this appeal. As we pointed out in that case, we start the analysis mindful of the requirement that exemption provisions must be narrowly construed. Taxation is the rule and exemption is the exception. *Budget Rent-a-Car, Inc. v. Dep’t of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972).

In 21 WTD 145, the consideration included both nonrecourse debt as well as other consideration. This determination addressed the period when the earlier, but substantively the same REET rule, WAC 458-61-374(1) was in effect. We stated:

Here, the taxpayer does not meet the express exemption allowed under Rule 374. The property transferred was subject to the first deed of trust, a debt upon which the grantor was liable. Accordingly, the transaction does not qualify for the exemption.

In the final analysis, whether the taxpayer is potentially liable should a default occur is not relevant to whether the exception applies. Following the decision in *Groesbeck v. Dep't of Revenue*, 63 Wn. App. 371, 818 P.2d 1121 (1991), RCW 82.45.010 was amended to remove from the definition of "sale" the exclusion for transactions in which the only consideration was the assumption of the balance owing on obligations secured by the real property transferred. As a result, the only related exception remaining is with respect to transfers subject to nonrecourse debt under Rule 374.

In order for us to include the taxpayer's transaction, which involved a transfer subject, in part, to a recourse debt, we would have to rewrite the Rule 374 exception. This we cannot do. See, e.g., *State v. Mollichi*, 132 Wash. 2d 80, 87, 936 P.2d 408, 411 (1997) ("[The court has] no license to rewrite explicit and unequivocal statutes."); *Soundgarden v. Eikenberry*, 123 Wash. 2d 750, 766, 871 P.2d 1050 (1994). In general, a court refrains from adding to, or subtracting from, the language of a statute unless imperatively required to make it rational. *Applied Indus. Materials Corp.*, 74 Wn. App. at 79 (citing *McKay v. Dep't of Labor & Indus.*, 180 Wash. 191, 194, 39 P.2d 997, 98 A.L.R. 990 (1934)). Rules of statutory construction apply to the interpretation of administrative rules and regulations. *Multicare Medical Ctr. v. Dep't of Soc. & Health Servs.*, 114 Wn.2d 572, 591, 790 P.2d 124 (1990).

....

In conclusion, we determine that the limited REET exemption described in WAC 458-61A-103(2) must be narrowly construed, consistent with the requirement that tax exemptions be narrowly construed. *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 173 Wn.2d 551, 558, 269 P.3d 1013 (2012), and *Budget Rent-a-Car*, 81 Wn.2d at 174, 500 P.2d 764 . . . As such, we affirm the calculation of the REET in this case where the nonrecourse debt was included in the measure of the sales price.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 17th day of June, 2014.