

Cite as Det. No. 19-0120, 40 WTD 207 (2021)

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. 19-0120
)	
...)	Registration No. . . .
)	

[1] RCW 82.45.010(3)(p); WAC 458-61A-211: REAL ESTATE EXCISE TAX – MERE CHANGE IN IDENTITY OR FORM. When two individuals who wholly own real property transfer the property to a limited liability company that they do not wholly own, the transfer does not qualify for the mere change in identity or form exemption.

[2] RCW 82.45.010(3)(i); WAC 458-61A-21: REAL ESTATE EXCISE TAX – CLEARING TITLE. When two individuals who own real property transfer the property to a limited liability company in exchange for ownership interests in the limited liability company, the transfer does not qualify for the clearing title exemption.

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. – Two individuals protest the Department’s assessment of real estate excise tax (“REET”) on their transfer of real property to a limited liability company. The individuals argue that the transfer was exempt from REET as a mere change in identity or form. Alternatively, the individuals argue that the transfer was exempt from REET as the clearing of title. We deny the petition.¹

ISSUES

1. Whether a transfer of real property, wholly owned by two individuals, to a limited liability company owned in part by those individuals qualifies for the mere change in identity or form exemption from REET under RCW 82.45.010(3)(p) and WAC 458-61A-211.
2. Whether a transfer of real property, wholly owned by two individuals to a limited liability company, in exchange for ownership interests in the limited liability company, qualifies for the clearing title exemption under RCW 82.45.010(3)(i) and WAC 458-61A-215.

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

FINDINGS OF FACT

[X] and [Y] (“Taxpayers”) purchased real property at . . . Washington (“Property”) on May 23, 2000. Taxpayers purchased Property as tenants in common, each owning 50 percent. Mr. [X] lived at Property until Taxpayers decided to develop and sell it.

On June 5, 2015, Taxpayers formed a limited liability company . . . (“LLC”), with . . . (“Partner”), to develop Property. Taxpayers owned a combined 50 percent interest in LLC, with Partner owning the remaining 50 percent. The intent of the parties was for Taxpayers to contribute Property to LLC and for Partner to contribute construction services for the construction of a substantially larger home on Property. Partner did undertake the construction of the larger home, but Taxpayers did not transfer Property to LLC when LLC was created.

LLC found an unrelated buyer for the newly constructed Property. LLC and the unrelated buyer arranged to close on the sale of Property for \$. . . on April 26, 2016. LLC paid REET on the selling price of the Property at that time. Taxpayers and Partner split the proceeds of the sale in accordance with their ownership interests.

Just prior to the sale, on April 25, 2016, Taxpayers transferred Property to LLC via quitclaim deed (“Transfer”). The next day, on April 26, 2016, Taxpayers filed a REET Affidavit regarding the Transfer, claiming an exemption from REET as a mere change in identity or form under WAC 458-61A-211.

On February 7, 2018, the Department’s Special Programs Division (“Special Programs”) notified Taxpayers that it was auditing the mere change in identity or form exemption Taxpayers had claimed for the Transfer. Special Programs requested documentation regarding the LLC, and Taxpayers provided the operating agreement. After reviewing the documentation, Special Programs concluded that the mere change in identity or form exemption did not apply to the Transfer. On April 4, 2018, Special Programs assessed Taxpayers a total of \$²

Taxpayers timely sought review of the assessment. Taxpayers argue the Department should consider the transfers exempt from REET as mere change in identity or form. Alternatively, Taxpayers argue that the transfer was also exempt from REET as the clearing of title.

ANALYSIS

REET is imposed on each sale of real property in Washington. 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). There are limited exemptions and exclusions from REET. WAC 458-61A-200.

1. The Mere Change Exemption Does Not Apply.

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

² The assessment consists of \$. . . in REET, an assessment penalty of \$. . . , and \$. . . in interest.

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:

(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:

(a) The transfer by an individual or tenants in common of an interest in real property to a corporation, partnership, or other entity if the entity receiving the ownership interest receives it *in the same pro rata shares as the individual or tenants in common held prior to the transfer*.

(Emphasis added). Therefore, when a transfer results in the owners not owning the property in the same pro rata shares as they did prior to the transfer, the exemption does not apply.

Here, the Taxpayers, which consisted of two individuals, owned Property 100 percent between the two of them before the Transfer to LLC (50 percent each). Taxpayers own only 50 percent of the LLC. Thus, the Transfer effectuated a 50 percent change in ownership, as [Partner] owned zero percent of Property prior to the Transfer and 50 percent thereafter. Before the transfer, Mr. [X] and Mr. [Y] each owned 50 percent of the Property and after the transfer they each owned 25 percent of the Property. Because the ownership percentages after the Transfer were not in the same pro rata shares as the ownership percentages prior to the Transfer, we hold that Special Programs correctly denied the mere change in identity or form exemption in RCW 82.45.010(3)(p) and WAC 458-61A-211.

2. The Clearing Title Exemption Does Not Apply.

A mortgage or other transfer of an interest in real property merely to secure a debt is exempt from REET. RCW 82.45.010(3)(i). WAC 458-61A-215(1), the rule that administers this statutory provision, states:

The real estate excise tax does not apply to quitclaim deeds given for the sole purpose of clearing title *if no consideration passes otherwise*. This rule does not apply to deeds executed for the purpose of adding persons to title, except in cases of persons added to title for co-signing security purposes only.

(Emphasis added.) WAC 458-61A-215(1) makes clear that the clearing title exemption does not apply if any consideration passes. “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.” WAC 458-61A-102(2). WAC 458-61A-102 includes this example of “consideration:”

“Consideration” includes the issue of an ownership interest in any entity in exchange for a transfer of real property to the entity. For example, if Julie transfers title to 20 acres of commercial property to Smith Development, LLC in exchange for a 50% ownership interest in the company, that constitutes consideration for the transfer. In the case of partnerships, consideration includes the increase in the capital account of the partner made as a result of the partner’s transfer of real property to the partnership, unless the transfer is otherwise specifically exempt under WAC 458-61A-211 or 458-61A-212.

WAC 458-61A-102(2)(a) (emphasis added).

Here, Taxpayers received ownership interests in the LLC in exchange for their transfer of Property to LLC. [³] Like the example from WAC 458-61A-102(2)(a), the ownership interests in the LLC constitute consideration, so the clearing title exemption does not apply here.

DECISION AND DISPOSITION

We deny Taxpayer’s petition.

Dated this 24th day of April 2019.

³ [While there is a gap between when Taxpayers received ownership interests from forming the LLC on June 5, 2015, and when they contributed Property on April 25, 2016, this gap does not affect whether the transfer of Property for the ownership interests was “consideration” for REET purposes under these facts.]