Cite as Det. No. 20-0290, 41 WTD 188 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON[1]

In the Matter of the Petition for Refund/Correction of Assessment of . . .	)))))))	D E T E R M I N A T I O N No. 20-0290 Registration No. . . .

WAC 458-61A-101; RCW 82.45.030: REAL ESTATE EXCISE TAX – SELLING PRICE – ARM'S LENGTH TRANSACTION – DISTRESSED PROPERTY – ENVIRONMENTAL CONTAMINATION. The negotiated price for the sale of real property, which was lower than the assessed value of the real property on the county property tax rolls, was found to be the selling price because the negotiated price was determined at arm's length between two unrelated parties, the property contained significant environmental contamination, and the negotiated price was supported by two independent appraisals.

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. – An individual seeks cancellation of an assessment of real estate excise tax levied as the result of its sale of real property. The individual objects to the Department's use of the county market value property tax assessment as the selling price of the real property at the time of sale. We grant the petition in part.

ISSUE

Whether the negotiated price for the sale of real property in this state constitutes the selling price of that real property under RCW 82.45.030 when that negotiated price is lower than the assessed value of the real property on the county property tax rolls, but the negotiated price was determined at arm's length between two unrelated parties and the property contains significant environmental contamination.

FINDINGS OF FACT

. . . ("Taxpayer") is an individual who resides in Washington. In 2005, Taxpayer purchased a gas station and the land upon which it sits (the "Property") with the intention of operating the gas station. Taxpayer financed the purchase with a commercial loan that was secured by the Property.

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

At the time of purchase, the Property was not operational as a gas station. It required interior and exterior remodeling as well as cleanup from environmental contamination. The realtor who brokered the sale told Taxpayer that environmental cleanup would only cost about $. . . . Taxpayer spent $. . . [five times the realtor's estimated amount] fixing the exterior of the gas station and . . . the gas pumps before he was able to reopen the gas station in 2006.

Taxpayer applied to refinance the loan secured by the Property in 2010. The Property was appraised at this time. The appraiser valued the Property at $. . . in total as a going concern and at $. . . [a lesser amount] for only the real property. Included in the refinance agreement were provisions to test for additional environmental contamination and to pay for any necessary cleanup uncovered thereby. One such provision required that Taxpayer place $. . . into escrow to be set aside for any future environmental cleanup. Separate from the money placed in escrow, Taxpayer paid a consulting company ("Consultant") to take soil and groundwater samples, which were then examined by the Washington Department of Ecology ("Ecology").

Invoices from Consultant show that Taxpayer paid $. . . to Consultant for the sampling at the Property and other related activities. Correspondence from Consultant indicates that additional sampling would cost Taxpayer another $. . . , without reference to actual cleanup of the contamination at the Property. Because this process identified contamination, but never actually resulted in any cleanup, the $. . . Taxpayer placed into escrow for cleanup was never dispersed.

Taxpayer refinanced again in 2014. Taxpayer provided a copy of the resulting appraisal, dated September 4, 2014. The 2014 appraisal values the Property under two scenarios: a hypothetical value, if it had no environmental contamination, of $. . . [amount less than the 2010 appraised value]; and an as-is value of "Less than $. . . [2014 appraised value]." The appraisal explains that $. . . [approximately 95%] of the hypothetical value is represented by the value of the Property itself. According to his website, the appraiser specializes in gas stations and other trade-related properties with intertwined business and real estate components. The appraiser notes that the environmental contamination at the Property affects both the soil and the groundwater.

The 2014 appraisal incorporates two different valuation methods: the income approach, which seeks to value a property by determining its potential to generate income; and the sales approach, which seeks to value a property based upon the values of similar properties in the relevant market. The appraiser did not apply the cost approach, which estimates the depreciated cost of a property's site and improvements, stating that it is not a significant consideration for buyers and sellers of similar properties. The appraiser states that most buyers are store operators as opposed to real estate investors.

In 2016, the bank holding the promissory note associated with Taxpayer's loan secured by the Property, sold the note to a third party . . . .[2] Shortly thereafter, the third party initiated non-judicial foreclosure proceedings against Taxpayer. Taxpayer sued to challenge. The dispute was eventually resolved in 2017 when a mediator determined that . . . [the third party] did not have legal grounds to foreclose.

[2] Prior to purchasing the note, . . . [the third party] offered to buy the Property from Taxpayer. Feeling that the offer was far too low, Taxpayer rejected it.

During the legal battle with . . . [the third party], Taxpayer decided to list the Property for sale. Listing agreements show that Taxpayer listed the Property for $[500,000][3]. . . in [early] 2016, then again in [late] 2016 and [early] 2017 at the same price. The final listing agreement, dated [late] 2017, does not specify a listing price, but is accompanied by a sales flier that advertises the selling price of the Property as $[600,000]. The eventual buyer contacted Taxpayer around the time that the final listing agreement was executed. After extensive negotiations, the buyer purchased the Property from Taxpayer for $[450,000],[4] with the sale closing [in] 2018. The [sales] price of $[450,000]. . . is reflected in both the sale agreement and in the final closing statement prepared by the escrow company. The closing statement also indicates that $ . . . of the sales price reimbursed the amount that Taxpayer had placed in escrow for environmental cleanup as a condition of the 2010 refinance. Taxpayer was not related to the buyer.

Taxpayer and the buyer completed a real estate excise tax ("REET") affidavit [in] 2018 and recorded it with the county auditor thereafter. The REET affidavit lists the gross selling price for the Property as $[400,000]. . . and its assessed price on the county tax rolls as $[750,000]. . . . Taxpayer paid REET based upon the $[400,000]. . . [gross selling price] stated on [the] REET affidavit.

Taxpayer listed the [gross] selling price in the REET affidavit as $[400,000]. . . , as opposed to the $[450,000]. . . [sales price] shown in the sale agreement and closing statement, based upon an attachment to the REET affidavit titled Business Opportunity Real Estate Addendum (the "Addendum"). The Addendum is an excerpt from the sales agreement, which is intended to delineate the portion of the selling price attributable to the Property from that which is attributable to gas station business opportunity. Notably, the Addendum, as attached to the REET affidavit, differs from how it reads as part of the sales agreement. In the sales agreement, the Addendum lists the portion of the sales price attributable to the business opportunity as "TBD." However, on the Addendum attached to the REET affidavit, the TBD is circled and a line is drawn extending from the circle to the margin where someone wrote "$[50,000]. . . [the difference in amounts between the sales price shown in the sale agreement, and the selling price listed by Taxpayer in the REET affidavit]." Neither Taxpayer nor the buyer initialed next to this purported change on the Addendum. There are four separate changes made to other provisions of the sales agreement that are written in the margins.[4] However, each such change is initialed by both Taxpayer and the buyer.

Review of the county tax rolls shows that the county assessor valued the Property at $[800,000]. . . in 2014, $[750,000]. . . in 2016 and 2017, and then increased the assessed value to $[900,000]. . . in 2018. This value change from 2017 to 2018 represents a . . . [20%][5]increase. The county tax rolls further show that, since the sale, the assessed value of the Property has decreased to $[650,000] . . . , as of 2020.

The Department's Audit Division ("Audit") became aware of the sale of the Property and selected the transaction for review. Audit requested additional information from Taxpayer about the sale, which Taxpayer provided. Audit concluded that the sales price did not represent the true value of

[3] [This is not the actual listing price. A proxy number was substituted for the redacted actual listing price to protect taxpayer confidentiality. All bracketed numbers (other than actual percentages) in the remainder of the determination are proxy numbers.]

[4] [This price excludes the cost of the store inventory, for which the buyer paid $. . . .]

[5] [Actual percentage.]

the Property, but that the assessed value did. Accordingly, Audit issued a tax assessment ("Assessment") against Taxpayer for the difference between the REET paid and that due on the assessed value on the [2018] county tax rolls of $[900,000]. . . , penalties, and interest. The Assessment comprises $. . . in REET, a substantial underpayment penalty of $. . . , and $. . . in interest. Taxpayer timely filed a petition for review (the "Petition") of the Assessment.

In support of the Petition, Taxpayer asserts that the assessed value as it appeared in the county tax rolls at the time of the sale did not represent the true and fair value of the Property. Taxpayer asserts that the listing agreements are a better measure because they involve realtors who, through professional experience, are good judges of property values in the relevant market. Further, Taxpayer asserts that the purchase price is completely reasonable when compared to the 2014 appraised value . . . .

Taxpayer also asserts that the county assessor's adjustments to local property values were inconsistent in the years leading up to the sale of the Property. Taxpayer submitted a case study of three properties that neighbor the Property, which shows that their assessed values grew at vastly different rates from 2014 through 2018. The assessed value for the first, a bar and grill, grew only about 2% over that time, while those of a motel and competing gas station grew 12% and 21%, respectively, whereas the assessed value of the Property increased by . . . [20%][6] from 2017 to 2018.

Taxpayer asserts that the fact that both the 2010 and 2014 appraisals included the gas station income in the calculation of the value of the Property does not negate the relevance of those appraisals to measuring the basis for REET, as Taxpayer asserts that the business had little value apart from the Property itself. Taxpayer asserts that the environmental contamination at the Property is well documented and supports that the sale price, rather than the assessed value on the county tax rolls, was the true and fair value of the Property at the time of sale.

Audit issued a response to the Petition in which it stated its position that Taxpayer has not submitted documents sufficient to show that the sales price was the true and fair value of the Property at the time of sale. Audit asserts that the selling price of the Property was a nominal selling price. Audit asserts that probative value of the 2010 and 2014 appraisals is undercut by both the fact that they take into account the income from the gas station and that neither was performed within a year of the sale. Audit also concluded that the closing statement for the sale constitutes evidence that there was no environmental contamination on the Property because it shows that the . . . [amount] that Taxpayer had placed in escrow for environmental cleanup was repaid to Taxpayer as part of the sale.

ANALYSIS

REET is imposed upon the sale of real property in Washington. RCW 82.45.060. "'[R]eal property' means any interest, estate, or beneficial interest in land or anything affixed to land . . . ." RCW 82.45.032(1). REET is measured by the "selling price." RCW 82.45.030.

[6] [Actual percentage].

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 . . . .

(Emphasis added.) [*See also* WAC 458-61A-102(22) (definition of "selling price").]

We recently addressed what constitutes an arm's length transaction in Det. No. 18-0232, 39 WTD 130 (2020). Therein, we stated:

> In general, an arm's length sale involves "a transaction negotiated by unrelated parties, each acting in his or her own self-interest; the basis for a fair market value determination." Black's Law Dictionary 100 (5th ed. 1979); *see also Washington v. Kleist*, 126 Wn.2d 432, 434, 895 P.2d 398 (1995) ("'Market value' is defined in this state as the price which a well-informed buyer would pay to a well-informed seller, where neither is obliged to enter into the transaction").

Here, Taxpayer and the buyer are unrelated parties who negotiated for several months before arriving at the final sales price. Audit does not assert to the contrary. While not required in every sale at arm's length, such extensive negotiations here further support that each party was acting in its own self-interest and that neither was obliged to enter into the transaction. We find that the sale at issue in this matter was an arm's length transaction between unrelated parties and turn now to whether the facts presented rebut the presumption in RCW 82.45.030(1).

We cannot determine true and fair value based on speculation, but must look to the objective evidence. *See In re Westlake Ave*., 40 Wn. 144, 150, 82 P.279 (1905). As the court stated in *In re Westlake*, market value is not limited to the value of the property to the owner. Instead,

> The market value of property is the price which it will bring when it is offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it. In estimating its value, all the capabilities of the property, and all the uses to which it may be applied or for which it is adapted, are to be considered, and not merely the condition it is in at the time and the use to which it is then applied by the owner. It is not a question of the value of the property to the owner . . . .

Id.; *see also Donaldson v. Greenwood*, 40 Wn.2d 238, 252, 242 P.2d 1038 (1952) ("'Fair market value' means neither a panic price, auction value, speculative value, nor a value fixed by depressed or inflated prices. . . .[but the amount] a purchaser willing, but not obliged, to buy the property would pay an owner willing, but not obligated, to sell it.")

The court's analysis in *Westlake* is reflected in WAC 458-61A-101(2)(c), which states that "true and fair value" is defined 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."

We have previously found the fact that a property was sold at a significant discount as sufficient to rebut the presumption under RCW 82.45.030(1) that the selling price represents the true and fair value of the property. [However, we have done so] only where the selling price was less than half of the value assessed on the county property tax rolls and the taxpayer fails to provide any justification for the discount. *See* Det. No. 17-0196, 37 WTD 053 (2018). In Det. No. 17-0196, we found that a steeply discounted sale price rebutted the presumption that the price was the true and fair value when that price was only 34% of the assessed value on the county property tax rolls and that taxpayer produced no appraisal of the property at issue or any other explanation for why the discounted sale price was acceptable to the seller. *Id*. at 54-56.

Here, Audit asserts that the selling price for the Property was so low in relationship to the assessed value maintained in the county property tax rolls that the difference rebuts the presumption under RCW 82.45.030(1). Taxpayer sold the Property for $[450,000]. . . in 2018. At the time of the sale, the county tax rolls showed that the county assessor valued the Property at $[900,000]. . . . Therefore, the selling price of the Property was . . . [58%][7] of the value on the county tax rolls. The tax rolls also show that the Property had been valued at $[800,000] . . . in 2014, at $[750,000]. . . in 2016 and 2017, and was decreased to $[650,000]. . . in 2020.

Independent appraisals of the Property valued it at $. . . [an amount less than the selling price] in total as a going concern and at $. . . [an amount less than the selling price] for only the real property in 2010 and at $. . . [an amount less than the selling price] in 2014. The 2014 appraisal was performed by an appraiser who specializes in gas station valuation and states that the valuation . . . assumes a hypothetical scenario where the Property had no environmental contamination. However, invoices and correspondence from Consultant make clear that the Property contains contamination that affects both the soil and the groundwater as they show several phases of sampling and significant charges to determine the extent of the contamination.

Audit asserts that the appraisals are not probative because they did not occur within a year of the sale and that the closing agreement from the sale shows a lack of environmental contamination. We disagree. While the appraisals cannot be used to show what the true and fair value of the property was because they did not value the property at the time of the sale at issue, they can be used as evidence to show that the property was worth less than the property tax assessed value (or, that the negotiated sales price was the true and fair value of the property). This is because they show that the property would have a lower value because of the environmental contamination. The evidence provided further shows that Taxpayer incurred expenses to evaluate the extent of contamination, but did not actually clean up the property. This evidence, taken together, shows why the property would be sold for less than the value assessed on the property tax rolls.

The facts in this matter are unlike those in Det. No. 17-0196, where we found the sale of a property at a significant discount was sufficient to rebut the presumption that the selling price represents the true and fair value of the property. There, the selling price was only 34% of the value on the county tax rolls and the taxpayer gave no explanation of why it accepted the price. Here, the selling

[7] [This is the actual percentage rather than the 50% percentage provided in the proxy numbers].

price of $[450,000]. . . is . . . [58%] of the assessed value for the Property on the county tax rolls. Further, Taxpayer has produced evidence to support the difference between the selling price and the value on the county tax rolls and that the property was worth less than the amount shown on the property tax rolls. As we found above, the sale of the Property was an arm's length transaction between unrelated parties. Considering circumstances surrounding the sale, there is nothing in the facts to rebut the presumption that the selling price represents the true and fair value of the Property. We turn next to whether the selling price was nominal.

A selling price in a real property transaction may still be set aside as the basis for REET and replaced with the value assessed in the county tax rolls if it is a nominal selling price. RCW 82.45.100(4); WAC 458-61A-303(6)(b). RCW 82.45.100(4) states:

> If upon examination of any **affidavits** or from **other information** obtained by the department or its agents it appears that all or a portion of the tax is unpaid, the department must assess against the taxpayer the additional amount found to be due plus interest and penalties.

(Emphasis added.)

WAC 458-61A-303 is the Department's administrative rule that addresses REET affidavits. It requires that affidavits be "complete," and states:

> [A]n affidavit is incomplete if any required information is omitted or obviously incorrect, such as the use of a nominal selling price. A nominal selling price is an amount stated on the affidavit that is **so low in comparison with the fair market value assessment stated on the property tax rolls that it would cause disbelief by a reasonable person**. In the case of a nominal selling price, the county assessed value will be used as the selling price, unless there is an independent appraisal showing a greater value.

WAC 458-61A-303(6)(b) (emphasis added).

Audit asserts that the selling price of the Property was a nominal selling price under WAC 458-61A-303(6) and that the value shown on the county tax rolls should replace the selling price as the measure of REET. We disagree. As we stated above, the two independent appraisals and documented environmental contamination are evidence to support why the selling price is the true and fair value of the Property. In light of such evidence we find that no reasonable person would experience disbelief in comparing the selling price with the value on the county tax rolls. Thus, we find that [the sales price was not a nominal selling price under WAC 458-61A-303(6)].

However, the REET affidavit is incomplete under RCW 82.45.100 and WAC 458-61A-303(6)(b) insofar as it lists the gross selling price for the Property as $[400,000]. . .. Taxpayer paid REET to the Department on that amount. The sales agreement and the closing agreement both list the selling price of the Property as $[450,000]. . . .

Washington follows the objective theory of contracts, which focuses on the outward manifestation made by the parties of mutual assent to the terms of a contract. *City of Everett v. Sumstad's Estate*, 95 Wn.2d 853, 855, 631 P.2d 366 (1981). Accordingly, contract modifications are only valid if there is an outward manifestation of the objective intention of the parties to mutually agree to the modification. *Wagner v. Wagner*, 95 Wn.2d 94, 103, 621 P.2d 1279 (1980). Such intention to agree to a modification "cannot be based on doubtful or ambiguous factors." *Id*.

Here, Taxpayer bases its listing of the gross selling price for the Property as $. . . on an un-initialed change on the copy of the Addendum it attached to the REET affidavit, which purports to designate $[50,000]. . . [the difference between the Taxpayer's listed gross selling price and the sales price] of the $[450,000]. . . sales price as attributable to the gas station business opportunity, rather than to the Property itself. Other changes to the sales agreement were initialed by both Taxpayer and the buyer. Because the change to the Addendum is not initialed by both Taxpayer and the buyer, and because other changes to the agreement were, there is considerable doubt as to whether both parties mutually assented to the change. In the absence of the parties initialing the change on the Addendum as an outward manifestation of their assent, we cannot find the change to be valid. *Wagner*, 95 Wn.2d at 103.

Therefore, the $[400,000]. . . price listed on the REET affidavit is obviously incorrect and a portion of the remaining tax remains unpaid. RCW 82.45.100(4); WAC 458-61A-303(6)(b). RCW 82.45.100(4), therefore, directs the Department to assess against Taxpayer the additional amount due plus interest and penalties. Accordingly, we remand this matter to Audit to assess REET plus any interest and penalties on the $[50,000]. . . difference between the actual selling price and the price upon which REET has already been paid.

DECISION AND DISPOSITION

Taxpayer's petition is granted [in part and denied in part.]

Dated this 29th day of October 2020.