

# Who Pays REET on Your Street: Washington State's Real Estate Excise Tax In Light of the 1991 Corporate Transfer Act and Beyond—How Can the Legislature Solve *Deer Park Pine*?

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# I. WHAT LIES AHEAD

The 1991 Corporate Transfer Act<sup>1</sup> represents a legislative attempt to close a court-made loophole that allows a sophisticated taxpayer to avoid Washington's Real Estate Excise Tax

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1. 1991 Wash. Laws 1st Spec. Sess. 22.

("REET"<sup>2</sup>). Specifically, this loophole allows a real estate owner to (1) create a corporation, (2) transfer his real estate to that corporation as a contribution to capital, (3) sell the corporation to a second individual, who would (4) liquidate the corporation, receive title to the real estate, and avoid REET.<sup>3</sup>

Despite the Washington State Legislature's 1991 attempt to close REET's loophole, several problems and a great deal of confusion still exist. In fact, the legislature left REET in a greater state of disrepair than before. The simplest method to address this dilemma would be to completely rewrite the REET statute. The legislature's attempt in 1992, however, failed.<sup>4</sup> As a result, Washington tax planners face a REET statute that leaves several unanswered questions and provides significant tax relief to the smart practitioner's client.<sup>5</sup>

The purpose of this Comment, therefore, is twofold. First, it gives the reader a complete understanding of Washington's real estate excise tax as it exists today. Here the reader will learn what REET is and how the Washington State Supreme Court, in a series of rulings, created the currently existing corporate transfer loophole. Second, this Comment advocates replacing the current law.

Specifically, this Comment takes the position that REET is in desperate need of repair; it then considers the options available to the Washington State Legislature in 1993. This Comment concludes that, with a few important alterations, the solution lies in a proposal that died in the House Revenue Committee in 1992.<sup>6</sup>

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2. REET is the acronym for Washington State's real estate excise tax as codified in WASH. REV. CODE ch. 82.45 (1989).

3. It is estimated that closure of the current loophole could raise an additional \$11.5 million of state revenue per fiscal year. See *infra* note 344 and accompanying text.

4. A proposal to completely rewrite Washington's REET was considered by the 1992 legislature. The 1992 proposal, however, was tabled for study prior to final legislative action to allow for further consideration of the proposal's probable effects on future realty transfers.

5. Discussion of federal taxation is beyond the scope of this Comment. Nevertheless, tax planners should consider federal tax requirements when planning REET transactions. For example, repeal of the General Utilities doctrine directly applies to corporate realty transfers. See *General Utilities and Operating Co. v. Helvering*, 296 U.S. 200 (1935); see also I.R.C. § 311(a)(2) (1954) (repealed 1986); BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* 7.20-23 (5th ed. 1987) (discussing General Utilities' doctrine and its repeal). Similarly, tax planners should study I.R.C. § 338 prior to a realty transfer by corporate merger or acquisition. See *generally* I.R.C. § 338 (1986).

6. In 1992, Substitute House Bill 2447 proposed eliminating REET's focus on a

## II. AN INTRODUCTION TO REET

### A. *Welcome to REET Street*

Now it is time to sit back, relax, and take a walk down REET Street.<sup>7</sup> Don't worry if at times you feel lost; you will not have been the first.

In 1951, when the planners developed REET Street, their vision was to generate revenue for education.<sup>8</sup> After a period of serene living on REET Street—no complications, no law suits, and a relatively straightforward tax statute<sup>9</sup>—the time came to remodel the street's decaying infrastructure. The tax consequences of REET were increasing as property values rose. In turn, as those consequences increased, so did the inequities among taxpayers.

The Washington State Supreme Court completed the first remodel of REET Street through a series of rulings in the 1950's and 1960's.<sup>10</sup> The court's remodel, however, left REET Street in a state of disrepair. Although the court did the best it could given the tools available, a few jogs were left in the road. The court's REET Street enabled some people to sneak by the tax collector unscathed, while their neighbors were left to pay. Several years passed before efforts were made to straighten the now crooked REET Street.<sup>11</sup>

The renovation of REET Street is back on the legislative docket. But today, there is a new generation of planners striving to transform REET Street into a viable and equitable revenue-generating community. Similar to the court's experience

"sale" as the taxable event. S.H.B. 2447, 52nd Leg., Reg. Sess. (1992). Instead, the proposal promoted taxation of any realty "conveyance." *Id.*

This Comment concludes that by using a realty conveyance as the taxable event, REET's current failings could be solved. *See infra* part IX. However, S.H.B. 2447 lacked adequate flexibility for legitimate corporate transfers. *Id.*

Thus, the 1993 legislature should modify the 1992 version of S.H.B. 2447. For guidance, the legislature should review certain provisions currently in effect in Delaware. *See infra* note 376 and accompanying text. By doing so, the legislature could solve REET's current failings equitably and effectively.

7. For the reader who lacks a basic understanding of what REET actually is, a detour to the next section is advised. *See infra* part II.B.

8. WASH. REV. CODE § 82.45.180 (1989).

9. *Id.* ch. 82.45.

10. *See* Christensen v. Skagit County, 66 Wash. 2d 95, 401 P.2d 335 (1965); Estep v. King County, 66 Wash. 2d 76, 401 P.2d 332 (1965); Doric Co. v. King County, 57 Wash. 2d 640, 358 P.2d 972 (1961); Deer Park Pine Industry, Inc. v. Stevens County, 46 Wash. 2d 852, 286 P.2d 98 (1955).

11. *See generally* WASH. REV. CODE ch. 82.45A (Supp. 1990-91); *see also* S.H.B. 2447, 52nd Leg., Reg. Sess. (1992).



in the 1950's and 1960's, however, the legislature has not accomplished its goals in one fell swoop. The legislature completed minor remedial maintenance in 1991,<sup>12</sup> but new holes appeared through the efforts of tax planners who found the pavement far from impervious. Thus, REET Street remains plagued with problems.<sup>13</sup>

This story of REET Street has three purposes. First, it will place the reader back in time and afford a glimpse of how and why REET Street came to be in its current state of disrepair. From this glimpse, the reader can consider the history of REET, its underlying principles, and its practical applications. Second, it will permit the reader to view those judicial efforts responsible for REET Street's current problems. Specifically, this story explains how a few key court rulings have created a significant REET loophole affecting transfers of realty made through corporations and partnerships. Third, it will allow the reader to review the legislature's latest efforts to rebuild REET Street, and it will compare those efforts to similar legislation from other states. The reader can then consider whether REET's renovation is finished, or whether REET Street's roadbed is still in need of repair. Most likely the reader will agree with this Comment's conclusion that the legislature's efforts in 1991 only made REET worse, and that today REET Street is in need of even greater repair than before.

You, as the reader, might only be interested in certain aspects of REET. You should, therefore, feel free to go anywhere on REET Street you desire: This Comment is your road map. Should you desire to learn how REET works today, begin at Section III. If your interest lies solely in learning how REET can be manipulated through corporate and partnership realty transfers, skip to Section IV. And if you are only concerned with the legislature's recent, and potential future efforts to close the corporate transfer loophole, skip to Section VI. Enjoy your tour of REET Street.

### B. *What Is REET?*<sup>14</sup>

Most states rely on three general types of taxes for reve-

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12. See Corporate Transfer Act, 1991 Wash. Laws 1st Spec. Sess. 22.

13. A complete discussion of the problems that currently plague Washington REET can be found *infra* part V.

14. For additional general background on REET, see RESEARCH DIVISION,

nue: income, property, and excise taxes. The State of Washington, however, relies on only two of these; it generates the bulk of its operating revenue without the use of an income tax,<sup>15</sup> thereby relying heavily on property and excise taxation. Generally, excise taxation refers to taxing a specific type of transaction or privilege.<sup>16</sup> In Washington, most excise taxes are measured by selling price or some other measure of income.<sup>17</sup> Although Washington's sales tax<sup>18</sup> and its use tax<sup>19</sup> are categorized as excise taxes, they apply to the sale and use of tangible personal property; therefore, real estate sales are not covered by either tax. Instead, REET covers all statutorily-defined real estate sales<sup>20</sup> based on the selling price of the real estate, including the balance of any liens, mortgages, or other debts.<sup>21</sup>

For fiscal year 1990, Washington State taxes totalled nearly \$7.0 billion.<sup>22</sup> During that period, REET generated \$265.17 million,<sup>23</sup> or 3.8 percent of the state's total revenue, not

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WASHINGTON STATE DEPARTMENT OF REVENUE, TAX REFERENCE MANUAL (1991) [hereinafter TAX REFERENCE MANUAL]; WASHINGTON RESEARCH COUNCIL, UNDERSTANDING WASHINGTON'S TAXES (1990); RESEARCH DIVISION, WASHINGTON STATE DEPT. OF REVENUE, TAX EXEMPTIONS-1990 (1990) [hereinafter TAX EXEMPTIONS]; WASHINGTON RESEARCH COUNCIL, REAL ESTATE EXCISE TAXES IN WASHINGTON STATE (1988).

15. Washington is one of seven states that does not impose a personal income tax along with Alaska, Florida, Nevada, South Dakota, Texas, and Wyoming. Washington is also one of five states with no corporate net income tax. Of the seven states that do not levy a personal income tax, Alaska and Florida do tax net corporate income.

Although attempts have been made to reform Washington's tax structure to include an income tax, those efforts have failed. The most recent attempt was by Governor Booth Gardner's Committee for Washington's Financial Future, which proposed an income tax in lieu of a percentage of the existing sales tax. Governor Gardner proposed that an income tax would generate a more stable revenue source and would be a more progressive taxing structure than the current regressive sales tax. However, voter confidence in the proposal failed to muster the necessary majority for the constitutional amendment required before an income tax could be initiated.

On the other hand, some commentators argue that a constitutional amendment should not be required in order to create a Washington State income tax. An article espousing such a view is scheduled to appear in the Winter 1993 issue of this Review. See Hugh D. Spitzer, *Washington State Income Tax—Again?*, 16:2 U. PUGET SOUND L. REV. (1993). Any further discussion on tax reform and its merits is beyond the scope of this Comment.

16. BLACK'S LAW DICTIONARY 506 (5th ed. 1979).

17. *E.g.*, WASH. REV. CODE Title 82 (1989).

18. *Id.* ch. 82.08.

19. *Id.* ch. 82.12.

20. *Id.* ch. 82.45.

21. *Id.* § 82.45.030.

22. TAX REFERENCE MANUAL, *supra* note 14, at 6-7.

23. *Id.*

including local taxes and state payroll taxes for workers' compensation programs. REET is clearly not the largest cash generator for Washington State coffers, yet it is considered a major state tax. It ranked sixth out of thirty-eight tax collection sources during the 1990 fiscal year.<sup>24</sup> The 1990 fiscal year was an exceptional year for REET collections, reflecting nearly a fifty percent increase<sup>25</sup> over the previous year due to a high appreciation rate in real estate values and an abnormally large number of property transactions during that period.<sup>26</sup>

### C. A History Lesson

In 1951, when REET Street was originally developed, the legislature permitted any county to levy an excise tax on real estate sales, as long as this tax did not exceed one percent of the selling price.<sup>27</sup> All but one-half of one percent of the proceeds from the tax were to be placed in the county's school fund.<sup>28</sup> The remaining one-half percent was retained by the counties to cover administration costs.<sup>29</sup> The legislature recognized during the 1951 second extraordinary<sup>30</sup> session that a contingency should be added to the statute.<sup>31</sup> The contingency provided state funds when the county tax failed to generate funding equal to the existing daily school attendance credit.<sup>32</sup> The 1951 second extraordinary session also provided an expanded version of REET that incorporated taxation for the sale of standing timber and excepted several transactions from the term "sale."<sup>33</sup> But while those transactions were excepted from the definition of "sale" for REET purposes, the legislature expanded the definition of "selling price," thereby

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24. *Id.*

25. *Id.*

26. For example, during fiscal year 1990 there were approximately 282,000 taxable real estate transactions in Washington, compared to an approximate average of 215,000 in recent years. *Id.* at 145.

27. Act of Apr. 16, 1951, 1951 Wash. Laws 1st Spec. Sess. 11.

28. *Id.*

29. *Id.*

30. Prior to 1991, the Washington State Code Revisor used the designation "extraordinary session." Since then, that term has been replaced by the designation "special session."

31. Act of Sept. 6, 1951, 1951 Wash. Laws 2d Spec. Sess. 19.

32. *Id.*

33. *Id.* WASH. REV. CODE § 82.45.010 (1989) currently defines the term "sale" and continues to expressly except several transactions as originally provided for in 1951. An in depth discussion of the statutorily defined "sale" for REET purposes begins *infra* part III.

increasing the amount of potential REET revenue.<sup>34</sup>

In 1955, the legislature exempted partitions of property and transfers under both divorce decrees and property settlements.<sup>35</sup> In 1959, counties were authorized to levy REET on conditional sales or purchase options of mining property.<sup>36</sup> During the 1967 extraordinary session, the legislature provided a credit for single family residential property subsequently transferred within nine months;<sup>37</sup> that credit is currently codified as Revised Code of Washington (RCW) 82.45.105.<sup>38</sup> Then, in 1970, the legislature exempted a transfer to a corporation wholly owned by the transferor, the transferor's spouse, or the transferor's children.<sup>39</sup>

During the late 1970's, funding for basic education had become recognized as a state responsibility.<sup>40</sup> Also becoming a significant concern was the lack of uniformity in tax collection by the various counties.<sup>41</sup> By 1981, REET was shifted to the state level for administration.<sup>42</sup> Despite this shift, county treasurers still collect the tax.

In 1982, it was evident to the legislature that REET needed more bite.<sup>43</sup> Consequently, the legislature increased the state base tax rate to 1.07 percent and authorized the first two local REET options allowing up to an additional .75 percent.<sup>44</sup> In 1987, the legislature repealed the state conveyance

34. WASH. REV. CODE § 82.45.010 (1989).

35. Act of Mar. 14, 1955, 1955 Wash. Laws 132 § 1.

36. Act of Mar. 20, 1959, 1959 Wash. Laws 208 § 1.

37. Act of May 11, 1967, 1967 Wash. Laws Spec. Sess. 149 § 61.

38. WASH. REV. CODE § 82.45.105 (1989).

39. Act of Feb. 24, 1970, 1970 Wash. Laws Spec. Sess. 65 § 1.

40. *Seattle School Dist. v. State*, 90 Wash. 2d 476, 518, 585 P.2d 71, 95 (1978) (en banc) (holding that WASH. CONST. art. 9 § 1 mandates the state sufficiently fund general public school education).

41. A prior effort to increase uniformity of the counties' administration of the tax by requiring the Department of Revenue to prescribe rules identifying uniform minimum standards failed. It was therefore repealed and exchanged for the current state administration of the tax. See Act of May 11 1967, 1967, Wash. Laws 1st Spec. Sess. 149, § 3 (effective July 1, 1967) (repealed) (stating that "the department of revenue is authorized and directed to prescribe minimum standards for uniformity in reporting, application, and collection of the real estate excise tax . . .").

42. Act of Apr. 1, 1980, 1980 Wash. Laws 154, replaced the county tax with a state excise tax on sales of real property. Later, 1981 Wash. Laws 93 recodified WASH. REV. CODE ch. 28A.45 (1979) as WASH. REV. CODE ch. 82.45 (1981).

43. See 1982 Wash. Laws 1st Spec. Sess. 49.

44. *Id.*; see also WASH. REV. CODE § 82.46.010(1) (1989) (providing a .25 percent local option to be used solely for capital improvements); *Id.* § 82.46.010(2) (providing a .5 percent local option to be used for general local government purposes). A complete discussion of the currently existing REET local options can be found *infra* note 61.

tax on real property transfers.<sup>45</sup> In its place, REET was increased from 1.07 to 1.28 percent to replace the revenue that the conveyance tax had previously generated.<sup>46</sup> In 1987, the legislature also imposed an additional .06 tax between May 18, 1987, and June 30, 1989, to provide funding for state acquisition of conservation lands by the Department of Natural Resources.<sup>47</sup> The latest local REET options were authorized by the legislature in 1990, providing up to an additional one percent for acquisition of conservation areas<sup>48</sup> and up to an additional 1.25 percent for approved capital improvement projects.<sup>49</sup>

The most recent legislative change to REET occurred during the 1991 legislative session. That change was engrossed substitute house bill (ESHB) 1831<sup>50</sup> and concerned the transfer of real estate by corporations. However, while ESHB 1831 was aimed at closing an existing REET loophole, the legislation has not accomplished its goal;<sup>51</sup> REET is still a state tax in disrepair. But before we explore REET Street's current failings, there remains a great deal of practical information to address.

#### *D. The Nuts and Bolts*

The Washington State Department of Revenue is primarily responsible for administering REET, including the promulgation of rules and enforcement actions.<sup>52</sup> Significantly, however, county treasurers actually collect the tax and retain one percent of the state's REET revenue as compensation for collection costs.<sup>53</sup>

REET payment must be accompanied by an affidavit form

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45. WASH. REV. CODE ch. 82.20 (1985), *repealed by* 1987 Wash. Laws 472. The conveyance tax equalled one dollar for each five hundred dollars of equity in real estate conveyed.

46. Because a portion of the conveyance tax had been dedicated by the 1985 legislature to local governments to maintain public works, an equivalent amount—7.7 percent—of REET revenue is still dedicated to local governments. *See* WASH. REV. CODE § 82.45.060(1) (1989).

47. *Id.* § 82.45.060(2).

48. *Id.* § 82.46.070 (Supp. 1990-91).

49. *Id.* §§ 82.46.010, 82.46.035.

50. Corporate Transfer Act, 1991 Wash. Laws 1st Spec. Sess 22 (creating a new chapter entitled "Excise Tax on Ownership Transfer of a Corporation" codified as WASH. REV. CODE ch. 82.45A (Supp. 1990-91)).

51. *See infra* part VI.A for an in depth discussion of E.S.H.B. 1831.

52. WASH. REV. CODE § 82.45.150 (1989).

53. *Id.* § 82.45.180.

signed by either the seller or the buyer of the property.<sup>54</sup> The affidavit memorializes the identifications of the buyer and the seller, a description of the parcel, the selling price, and other pertinent information.<sup>55</sup> In most counties, both payment of the tax and receipt of the affidavit are conditions to recording the transfer.<sup>56</sup>

While the real estate seller is typically liable for REET, the buyer is ultimately liable if the tax is not paid.<sup>57</sup> Furthermore, the one percent county option authorized by RCW 82.46.070 specifically imposes the tax upon the purchaser, not the seller. Because REET liability provides for a lien that may be foreclosed by the county,<sup>58</sup> it is in the buyer's best interest to make sure the tax is paid.<sup>59</sup>

The base tax rate, imposed by the state, is 1.28 percent.<sup>60</sup> While the tax is primarily a state tax, the legislature has enabled local governments to take advantage of local options for increasing the tax rate if they desire.<sup>61</sup>

54. The Department of Revenue is required to produce this affidavit pursuant to WASH. REV. CODE § 82.45.120 (1989). The affidavit can be attained from the department or a county treasurer and is currently enumerated as Form Rev. 84-0001 (1988).

For federal tax reporting purposes, Form 1099-S (Proceeds From Real Estate Transactions) applies to transactions with closing dates after December 31, 1986.

55. Currently, there is some discussion that confusion arising from the buyer's liability under WASH. REV. CODE § 82.46.070 (Supp. 1990-91) might necessitate an additional affidavit form or a revision of the one currently being used.

56. GRAHAM H. FERNALD, WASHINGTON STATE BAR ASSOCIATION, REAL PROPERTY DESKBOOK § 72.66 (2d ed. Supp. 1986 & 1989).

57. WASH. REV. CODE § 82.45.080 (1989).

58. *Id.* §§ 82.45.070, 82.46.040.

59. The tax is due and payable immediately upon sale of the property. *Id.* § 82.45.100. If it is not paid within thirty days after the sale, it will bear interest at the rate of one percent per month from the date of sale until the date of payment. *Id.* In addition, if the tax is not received by the county treasurer within thirty days of the due date, a five percent penalty is assessed; after sixty days, the penalty increases to ten percent; and after ninety days, it totals twenty percent. *Id.* Penalties are collected from the seller only. *Id.*

60. WASH. REV. CODE § 82.45.060 (1989). Receipts from the state tax are deposited in the state general fund solely for education of grades kindergarten through high school and for public works funding. *See id.* (earmarking public works funds); *Id.* § 82.45.180 (earmarking common school funds).

61. Local taxing options include the following:

1. WASH. REV. CODE § 82.46.010(1) (Supp. 1990-91) allows counties and cities to impose up to an additional .25 percent tax to be used solely for capital improvements. Because most counties and cities have implemented this option, the combined state and local REET rate is at least 1.53 percent in most areas of the state. Washington Tax Guide (CCH) ¶ 56-548 (1990) [hereinafter Tax Guide].
2. WASH. REV. CODE § 82.46.010(2) (Supp. 1990-91) allows counties and cities to impose up to an additional .5 percent tax, but only if the local

As just discussed, the amount of REET liability incurred through a given real estate transaction varies depending on the local options that are exercised.<sup>62</sup> Yet, while REET's rate may vary, REET is always calculated as a percentage of the selling price. For REET purposes, selling price is defined in RCW 82.45.030 as the consideration, including money or anything of value, paid, delivered or contracted to be paid for the transfer of an interest in real property.<sup>63</sup> The selling price also includes the amount of any indebtedness accepted by the purchaser to secure the purchase of the property.<sup>64</sup> The selling price does not, however, include any encumbrances in favor of a government entity for taxes or special improvements.<sup>65</sup>

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government does not impose the second .5 percent local sales tax increase pursuant to WASH. REV. CODE § 82.14.030(2) (1989). By January of 1991, the city of Clarkston was the only jurisdiction to have chosen this REET increase, which may be used for general local government purposes. TAX REFERENCE MANUAL, *supra* note 14, at 143.

3. WASH. REV. CODE § 82.46.070 (Supp. 1990-91) authorizes counties to impose an additional 1.0 percent tax for the acquisition and maintenance of conservation areas. The legislature passed this option in 1990, and as of January 1991, San Juan County was the sole jurisdiction to implement it. TAX REFERENCE MANUAL, *supra* note 14, at 143. This is the only local option that, if passed by the county, will also apply in the incorporated areas within that county. All other local options if levied by the county will not apply within the county's incorporated areas, and, if levied by cities, will only apply within that city's limits. WASH. REV. CODE § 82.46.010-035 (Supp. 1990-91).
4. WASH. REV. CODE § 82.46.035 (Supp. 1990-91) authorizes counties and cities to impose up to an additional .25 percent tax to be used solely for capital projects specified in a comprehensive plan. While this option may be implemented by the local legislative body in high growth counties, such as Clark County and the Puget Sound basin, it must receive voter approval in all other jurisdictions. *Id.*

After considering all of the available local options, there is potential for a combined local and state tax rate of 3.28 percent. Such a rate could spur concerns that a tax of that magnitude might detrimentally affect the real estate market. See WASHINGTON NATIONAL TAX SERVICE, PRICE WATERHOUSE, AN ANALYSIS OF STATE AND LOCAL REAL ESTATE TRANSFER TAXES (1988) (providing an economic analysis of REET). However, no Washington jurisdiction has implemented the maximum rate. Instead, the typical current rate for REET remains at 1.53 percent, which includes the state 1.28 percent base rate and the .25 percent local option authorized by WASH. REV. CODE § 82.46.010(1) (Supp. 1990-91). See Tax Guide, *supra* note 61, at ¶ 56-548 (providing a complete table of combined state and local REET rates in Washington State).

62. Local options are discussed *supra* note 61. For a table of local REET rates throughout Washington, see Tax Guide, *supra* note 61, at ¶ 56-548.

63. WASH. REV. CODE § 82.45.030 (1989).

64. *Id.*; see also 51-53 Op. Att'y Gen. 99 (1951) (selling price includes both the consideration paid or contracted for the assignment of, and any unpaid balance due on, an assumed contract secured by title on the property).

65. WASH. REV. CODE § 82.45.030 (1989).

### III. WHO PAYS REET ON YOUR STREET? DETERMINING TAXABLE TRANSACTIONS

For purposes of determining which transactions are taxable under the REET statute, two sections are of primary importance: RCW 82.45.030, defining "selling price," and RCW 82.45.010, defining "sale." The statute's definition of sale is inclusive and includes any transfer of an interest in real property, including standing timber, in exchange for "a valuable consideration."<sup>66</sup> The statutory definition of "sale" also includes any contractual purchase or lease with an option to purchase when the seller retains title as security for the payment of the purchase price.<sup>67</sup> From this inclusive definition of taxable transactions, the statute lists several exemptions.<sup>68</sup>

#### A. *Statutory Exemptions*

REET's underlying purpose is to tax transactions that constitute sales in open market contexts. Therefore, transfers by gift,<sup>69</sup> inheritance,<sup>70</sup> divorce decree, foreclosure proceedings,<sup>71</sup> partition by court order, or condemnation<sup>72</sup> are exempt from REET liability. The primary beneficiaries of these statutory exemptions are those who acquire real estate by gift or inheritance.<sup>73</sup>

66. *Id.* § 82.45.010.

67. *Id.*

68. *Id.*

69. Some confusion may exist when nominal consideration is granted in a deed by gift, possibly to diminish warranty deed liability or to furnish support for the conveyance and insurance against revocability of quit claim deeds. See Annual Survey of Washington Law, *Applicability of Real Estate Sales Tax to Transfers for Benefit of Unformed Corporation*, 41 WASH. L. REV. 583, 585 (1966) [hereinafter Survey]. When the deed recites nominal consideration such as "for \$1 and love and affection," the issue is whether the transaction was a gift, not whether a dollar actually passed. Because, in such instances, the recital in the deed is of little assistance, a much better guide to determine whether the transfer was actually a gift is the seller's affidavit (Form 84-0001), because that affidavit must disclose under oath the true consideration given. 53-55 Op. Att'y Gen. 34 (1953).

70. But, if an heir to an undivided interest in real property, which would pass upon the death of the owner of the land, deeds that interest prior to inheritance, that transaction is subject to the tax. 51-53 Op. Att'y Gen. 98 (1951).

71. However, assignment of a sheriff's certificate of sale by a purchaser who requests that the deed be issued to a third person is a taxable assignment. Unlike an original foreclosure sale, which is exempt, the assignment to a third party is voluntary and not an exempt conveyance under court order. 57-58 Op. Att'y Gen. 146 (1958).

72. A sale of real property made merely under the pressure of condemnation is still a taxable transaction. 51-53 Op. Att'y Gen. 59 (1951).

73. And while these exemptions totaled roughly \$178 million for the 1989-1991 biennium, it is unlikely that they will be repealed not only because of the tax policy of



A transfer of a leasehold estate is exempt from REET<sup>74</sup> as long as it is not a lease with an option to purchase.<sup>75</sup> Also exempt is the forfeiture of a buyer's contract interest in lieu of foreclosure<sup>76</sup> where no consideration otherwise passes.<sup>77</sup> An assignment or sale of a seller's real estate contract,<sup>78</sup> a mortgage or transfer "merely to secure a debt," and transfers pursuant to lien foreclosure proceeding are also expressly exempt

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facilitating the underlying transactions, but also because of the difficulty that would result in establishing equivalent sale prices to calculate the percentage of tax due.

74. See *State ex rel. Namer Investment Corp. v. Williams*, 73 Wash. 2d 1, 435 P.2d 975 (1968) (upholding the exemption for leasehold transfers); see also WASH. ADMIN. CODE § 458-61-500 (1989).

75. When a lease option is in question, the transaction is taxable when the agreement originates, unless (1) the option to purchase must be exercised within two years after commencement of the lease and the total of the lease payments will not exceed one-half of the purchase price, or (2) none of the lease payments apply towards the ultimate selling price. WASH. ADMIN. CODE § 458-61-510 (1989). Furthermore, the Department of Revenue has the authority to determine the selling price for REET purposes on leases with options to purchase. WASH. REV. CODE § 82.45.035 (1989). And although every unexercised lease-option agreement may not be subject to the real estate excise tax, it does not indicate a failure to tax equally all persons within the lease option category. *Williams*, 73 Wash. 2d at 11, 435 P.2d at 981.

Even before the legislature expressly included lease option in the definition of "sale" pursuant to WASH. REV. CODE § 82.45.010 (1989), the court recognized that it was consistent with the legislative purpose of the act to include lease options as sales because, if not, the transaction vehicle could easily be used to evade the tax. *Id.*

76. If the contract contains a proper forfeiture clause, the action is one to forfeit, and because no consideration passes, no tax is due. However, if the contract fails to contain a proper forfeiture clause, the seller will be left to foreclose his lien on the title, which will result in a judgment and sale on the execution of that judgment. Because the latter constitutes a sale for consideration, whether sold to the original seller or a third party, that sale has been ruled to be taxable. 51-53 Op. Att'y Gen. 447 (1952).

77. The statute exempts "the assumption by a grantee of the balance owing on an obligation which is secured by a mortgage of deed in lieu of forfeiture of the vendee's interest in a contract of sale where no consideration passes otherwise." See 55-57 Op. Att'y Gen. 95 (1955). If consideration does pass, however, the measure of the tax is the consideration that passes plus the balance owing on the contract. See 55-57 Op. Att'y Gen. 141 (1955). There does not appear to be any limitation that the party assuming a mortgage obligation must be the mortgagor itself. See *id.* The term "sale" does not apply to the transfer of a purchaser's contract interest to a third party where no consideration passes except the obligation to assume the unpaid balance of the purchase price. 57-58 Op. Att'y Gen. 95 (1957).

While the transfer by the mortgagor to the mortgagee in lieu of foreclosure is not taxable under WASH. REV. CODE § 82.45.010 (1989), a subsequent resale under contract to the mortgagor is a taxable transaction even though the resale was part of the overall agreement to avoid foreclosure. 65-66 Op. Att'y Gen. 47 (1965).

78. Even when accompanied by a warranty deed, the assignment of a seller's interest in a contract to convey real property is not a taxable transaction where the sole interest of the assignor is as the seller of an unperformed contract to purchase the property. 51-53 Op. Att'y Gen. 220 (1952).

from the definition of sale.<sup>79</sup>

RCW 82.45.010 further exempts property acquired by and from government entities,<sup>80</sup> along with conveyances to the Federal Housing Administration or the Veteran's Administration under their insurance guaranty contracts. Sales of graves or lots in established cemeteries are exempt.<sup>81</sup> And transfers to a corporation "wholly owned by the transferor, his spouse, or his children" are not taxable as long as the transferee corporation does not transfer the property, or as long as the transferor or the transferor's spouse or children do not transfer the stock, within five years of the original exchange.<sup>82</sup>

An additional REET exemption provides a credit for the amount of tax paid on single family residential property.<sup>83</sup> The property, however, must be taken in trade for part of the consideration of another single family residence, and the property must be transferred by a real estate broker or other party within nine months.<sup>84</sup> If the second transfer of the property incurs greater tax liability than the first transfer, only the difference in REET liability is owed.<sup>85</sup> If, on the one hand, the tax due on the second transfer is less than the first transfer, no refund is available.<sup>86</sup>

The REET exemptions, however, are not what make tax planning of real estate transactions confusing and uncertain. The difficulty confronting the tax planners working on REET Street, and the legislators striving to remodel it, lies in determining what satisfies the statutory requirement that a "sale" be a transfer for "a valuable consideration."<sup>87</sup> The following section provides a few examples of how, in practice, REET liability is incurred.

79. WASH. REV. CODE § 82.45.010 (1989).

80. However, this exemption is of minor impact; it only totalled roughly \$9.4 million for the 1989-1991 biennium. TAX EXEMPTIONS, *supra* note 14, at 189.

81. WASH. REV. CODE § 82.45.010 (1989).

82. *Id.* (overruling 55-57 Op. Att'y Gen. 25 (1955) (holding that transfer of property to a corporation for stock issued to a husband and wife as their interests appear is taxable)).

83. WASH. REV. CODE § 82.45.105 (1989).

84. *Id.*

85. *Id.*

86. *Id.*; cf. 57-58 Op. Att'y Gen. 70 (1957) (decided before the passage of WASH. REV. CODE § 82.45.105 (1967)).

87. *Id.* § 82.45.010 (1989).

### B. Specific REET Transactions

The following transactions illustrate REET and several of its unpredictable applications.<sup>88</sup>

#### 1. Concurrent Estates: Is There Consideration?

A brief overview of REET applicability in the context of concurrent estates<sup>89</sup> demonstrates that consideration is the key to determining whether a transaction is taxable.

At common law, the creation of a joint tenancy required two real estate transactions: the first transferred title to a straw person, and the second regranted title to the newly joined joint tenants. Today, pursuant to RCW 64.28.010, the first transfer—to a straw person—is no longer necessary.<sup>90</sup> The real estate excise tax, however, will not apply in either case when no consideration is given for the transfers.<sup>91</sup> Consider the following joint-tenancy transaction. Brother transfers individually owned real estate in accordance with an agreement, reciting consideration of love and affection. Pursuant to the agreement, the real estate is transferred to Brother and Sister as joint tenants. While technically a real estate transaction has taken place, there has been no exchange for a valuable consideration and, therefore, there is no tax liability.<sup>92</sup>

As for a tenancy in common, neither partition of property "by agreement or as a result of a court decree" is a taxable transaction because of its express exemption from the definition of sale.<sup>93</sup> However, the exemption in RCW 82.45.010 does

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88. The variety of real estate transactions that take place in today's society give rise to a multitude of questions concerning the applicability of REET. A complete discussion of all such issues are beyond the scope of this Comment.

Unfortunately, there is no definitive work produced that outlines REET liability for the myriad of real estate transactions that take place. However, a summary of all the authoritative materials on the subject has recently been completed and can provide the tax planner with a reference point from which to start researching a specific issue. See JUDEE WELLS, *REAL ESTATE EXCISE TAX DESKBOOK* (1991) (indexing cases, Washington Tax Determinations, Attorney General Opinions, Excise Tax Bulletins, and other materials).

89. "Concurrent estates" is defined as the ownership or possession of property by two or more persons at the same time. BLACK'S LAW DICTIONARY 264 (5th ed. 1979).

90. WASH. REV. CODE § 64.28.010 (1987). WASH. REV. CODE § 64.28.010 states that a joint tenancy "may be created by a single agreement, transfer, deed, will or other instrument from a sole owner to himself and others . . ."

91. See WASH. REV. CODE § 82.45.010 (1989) (defining a taxable sale as a transfer of ownership "for a valuable consideration").

92. 61-62 Op. Att'y Gen. 86 (1961).

93. WASH. REV. CODE § 82.45.010 (1989). This express exemption was created by

not cover a sale, as opposed to merely the partition, of that property.<sup>94</sup> If the property is sold pursuant to an action to partition property owned by tenants in common, the transaction is a taxable sale.<sup>95</sup> Therefore, when one of the joint purchasers of the property voluntarily transfers his or her interest in a contract sale to the remaining purchaser, that transfer is a taxable transaction.<sup>96</sup> The selling price, for REET purposes, will be the consideration delivered in return for the transfer.<sup>97</sup> That consideration is measured by the selling price paid for the transferring purchaser's equity, plus the proportional share of the unpaid balance owed by the transferring purchaser at the time of the transfer.<sup>98</sup>

In sum, the key to determining REET liability in the context of joint tenancies and tenancies in common is to determine if consideration has actually passed between the fee owners.

## 2. Trusts

When transfers involving trusts are at issue, once again, it is important to remember that REET requires consideration in exchange for a transfer of ownership in real estate before tax liability arises. Therefore, REET does not apply to a transfer of real property from the owner into a trust for that same owner because the transfer does not constitute a sale under RCW 82.45.010.<sup>99</sup> Neither naming beneficiaries nor reserving the right to revoke the trust should have any bearing on the lack of consideration for such transactions.<sup>100</sup> A trustee may also hold property for a corporation not yet in existence when the trust is established. Then, once the corporation is formed and the trustee transfers the realty to the corporation, the transaction will not constitute a taxable sale.<sup>101</sup>

For example, in *Senfour Investment Co. v. King County*,<sup>102</sup>

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amendment following 51-53 Op. Att'y Gen. 98 (1951), and it clearly supersedes Attorney General's ruling that partition actions constitute taxable transactions.

94. *Id.*

95. 57-58 Op. Att'y Gen. 8 (1957).

96. 65-66 Op. Att'y Gen. 64 (1965).

97. WASH. REV. CODE § 82.45.030 (1989).

98. *Id.*

99. *Id.* § 82.45.010.

100. *Id.*

101. *Senfour Investment Co. v. King County*, 66 Wash. 2d 67, 401 P.2d 319 (1965); see also 61-62 Op. Att'y Gen. 133 (1962).

102. 66 Wash. 2d 67, 401 P.2d 319 (1965).

a corporate promoter entered into an agreement to purchase real estate on behalf of an unformed corporation.<sup>103</sup> Upon the date of closing, the corporation had not yet been completely formed.<sup>104</sup> To avoid losing the property, the promoter and two nominees purchased the property as trustees.<sup>105</sup> The seller paid the real estate excise tax because the transaction was clearly a sale as defined by the tax.<sup>106</sup> One month later the corporation was completely formed. Pursuant to the trust agreement the three trustees transferred the realty to the corporation by quit claim deed, reciting nominal consideration.<sup>107</sup> King County assessed a tax on the transfer, alleging that it was a second sale.<sup>108</sup> The tax was assessed to the trustees who were also the corporation's officers.<sup>109</sup> The trustees, in turn, paid in protest and filed suit claiming that the transfer to the newly formed corporation did not constitute a second transaction for tax purposes.<sup>110</sup> The court agreed and held that where failure to complete the incorporation process before the closing date forces the incorporators to accept the property in trust for the corporation, the transfer from the trustees to the newly formed corporation does not constitute a taxable sale.<sup>111</sup>

Thus, realty transfers made through trusts provide another example of the role that consideration plays in invoking REET; namely, nominal consideration is insufficient.

### 3. Standing Timber: Who Says It's Realty?

While consideration is a prerequisite for determining whether a sale is a taxable transaction, it is also important to remember that REET applies solely to the transfer of real property and does not apply to personal property transactions. Nevertheless, as in the case of standing timber, not everyone agrees on the definition of real property.

Prior to the passage of REET in 1951, timber sales, which required immediate severance of the timber, were not taxable sales of real estate.<sup>112</sup> However, following the statute's pas-

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103. *Id.* at 68, 401 P.2d at 320.

104. *Id.*

105. *Id.*

106. *Id.*; see WASH. REV. CODE § 82.45.010 (1989).

107. *Senfour*, 66 Wash. 2d at 68, 401 P.2d at 320.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 70, 401 P.2d at 321.

112. See 51-53 Op. Att'y Gen. 234 (1952).

sage, all sales of standing timber after September 6, 1951, became subject to REET.<sup>113</sup>

By taxing standing timber, the statute is potentially inconsistent. The Washington Supreme Court has stated that when a contract for the sale of standing timber provides for immediate severance, the timber itself is personal property and not real property.<sup>114</sup> Because REET taxes the transfer of "real property,"<sup>115</sup> one could reasonably conclude that a sale of standing timber should not be subject to REET if the timber is intended to be immediately severed. However, the REET statute was expressly amended to include standing timber within the definition of sale,<sup>116</sup> thereby creating an inconsistency, but clearly making the sale of standing timber a taxable transaction.<sup>117</sup>

When considering REET liability in a timber transaction,<sup>118</sup> therefore, the requirements for "consideration"<sup>119</sup> and the statutory definition of "sale"<sup>120</sup> should be considered. Significantly, the character of the timber in question should also be considered. For instance, one should ask whether the tim-

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113. *Id.* Pursuant to New York State's Real Estate Transfer Tax, a transfer of standing timber is also taxed as a realty transfer. Adopted Regulation, 1990 N.Y. Tax LEXIS 523, at \*4 (N.Y. Comm'r Tax & Fin. Oct. 22, 1990) (providing regulations promulgated pursuant to N.Y. TAX LAWS §§ 171, 1407, 1415(a), 1416(a), 1419(b) (Consol. 1990)). An analysis of New York's Realty Transfer Tax can be found *infra* part VII.A.

114. *Elmonte Investment Co. v. Schafer Bros. Logging Co.*, 192 Wash. 1, 72 P.2d 511 (1937); see also Ralph W. Johnson, *Washington Timber Deeds and Contracts*, 32 WASH. L. REV. 30 (1957) (discussing confusion surrounding the sale of standing timber in real property law).

115. WASH. REV. CODE § 82.45.010 (1989).

116. *Id.*

117. It has been argued that this inconsistency may be of constitutional magnitude under WASH. CONST. art. 2, § 19, providing that "[n]o bill shall embrace more than one subject, and that shall be expressed in the title." Lawrence P. Gamroth, Comment, *Washington Real Estate Excise Tax: An Analysis and a Survey*, 3 GONZ. L. REV. 89, 93 (1968) (citing *YMCA v. Washington*, 62 Wash. 2d 504, 506, 383 P.2d 497, 499 (1966), for support). However, this argument is misfounded because inclusion of standing timber in WASH. REV. CODE § 82.45.010 (1989) concerns a statute, as opposed to merely a bill. While the statute embraces more than one subject, the statute is a collection of several bills that have been passed over several years. See also *State ex rel Namer v. Williams*, 73 Wash. 2d 1, 435 P.2d 976 (1968) (holding that REET taxation of a lease-option is constitutionally violative).

118. A complete in-depth analysis of Washington's taxation of timber transfers is beyond the scope of this Comment. For a more in-depth analysis of Washington's timber tax, see JOHN CONKLIN, RESEARCH DIVISION, WASHINGTON STATE DEPARTMENT OF REVENUE, *A REVIEW OF FOREST TAXATION IN WASHINGTON* (1980).

119. The consideration requirement under REET is discussed *supra* part III.

120. The statutory definition of a "sale" under REET is discussed *supra* part III.

ber should be severed before or after the closing of the sale.<sup>121</sup>

Thus, standing timber sales provide an opportunity to study another significant REET principle. While the transfer of consideration is one underlying principle of REET, so is the principle that the tax is imposed on the sale of real property (as defined by RCW 82.45.010), not personal property.

#### IV. JUDICIAL INTERPRETATIONS OF CORPORATE REAL ESTATE TRANSFERS BETWEEN 1955 AND 1991: A LOOPHOLE IS FORMED

As illustrated above, consideration is the root for determining the taxability of REET transactions. Specifically, the taxability of individual transactions under REET is based on a transfer "for a valuable consideration."<sup>122</sup> Significantly, however, the courts, the Attorney General, and the Department of Revenue have all experienced difficulty in determining what kind of transactions provide adequate consideration to invoke the tax.<sup>123</sup> It seems clear that nominal consideration<sup>124</sup> for a transfer will not invoke the tax.<sup>125</sup> One might also conclude

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121. "It should be noted that what we have said [that a contract or conveyance of standing timber is taxable even if it contemplates immediate severance] applies to sales which pass title while the timber is standing." 51-53 Op. Att'y Gen. 234 (1952) (emphasis added). In addition, it should be noted that where blown down timber is substantially severed from the real property, it becomes tangible personal property and REET does not apply. See Tax Guide, *supra* note 59, at ¶ 56-508 n.881.

122. WASH. REV. CODE § 82.45.010 (1989) (defining sale); *id.* § 82.45.030 (defining selling price).

123. "Determining what constitutes a conveyance of an interest in real property for valuable consideration has been a prime problem in administering the tax." Gordon G. Conger, Note, *County Imposed Real Estate Excise Tax—Applicability to Corporate Transfers and Dissolution*, 37 WASH. L. REV. 219, 220 (1962) (discussing the administrative difficulties of the tax when solely administered by the counties; however, simply because the state now administers the tax, the same problem exists).

124. To hold that a horse, hawk, or robe is sufficient, in and of itself, to assess a tax on a real estate transaction would ignore that nothing was bargained for the exchange. "Consideration must actually be bargained for as exchange for the promise." RESTATEMENT OF THE LAWS OF CONTRACTS § 75 cmt. b (1932); see also *Universal C.I.T. Credit Corp v. DeLisle*, 47 Wash. 2d 318, 287 P.2d 302 (1955); *Snyder v. Roberts*, 45 Wash. 2d 865, 278 P.2d 348 (1955).

Furthermore, because transfers of real property can be accomplished without the recitation of even nominal consideration, assessing REET simply because nominal consideration is part of the transaction would only create a trap for the unwary. Survey, *supra* note 69, at 583-85.

125. See, e.g., *Senfour Investment Co. v. King County*, 66 Wash. 2d 61, 401 P.2d 319 (1965) (holding that nominal consideration for the transfer of property from a trust to a newly formed corporation does not invoke the tax); see also 53-55 Op. Att'y Gen. 34 (1953) (ruling that nominal consideration reciting "\$1 and love and affection" does not destroy the express gift exemption of WASH. REV. CODE § 82.45.010).

that, for REET purposes, "the essence of a 'transfer' . . . is the passage of control over the economic benefits of property rather than any technical changes in its title."<sup>126</sup> Nevertheless, the consideration difficulty has forced the courts to create some rather inconsistent rules concerning particular types of real estate transfers. The most noticeable inconsistency involves realty transfers by corporations and partnerships. In this type of transfer, a loophole in REET has emerged where corporations and partnerships are used as the real estate transfer vehicle.<sup>127</sup>

Ordinarily, there is no conveyance for a valuable consideration where change of title is effected solely as a result of its distribution to the stockholders of a solvent corporation in the process of dissolution.<sup>128</sup> The court determined, however, in *Deer Park Pine Industry, Inc. v. Stevens County*,<sup>129</sup> that where a voluntary assumption of the liabilities of a dissolving corporation by the stockholders occurs, the transaction is a taxable conveyance to the extent of the assumed debt.<sup>130</sup>

While the court found the realty transaction in *Deer Park* subject to REET,<sup>131</sup> the court's reasoning created the foundation for a trilogy of cases<sup>132</sup> that later made it possible to avoid REET by transferring realty as a corporate asset. The following subsections outline the steps the court took in creating that loophole.

#### A. *Step One: Deer Park Pine Industry, Inc. v. Stevens County*

In *Deer Park*,<sup>133</sup> two corporations acquired one hundred percent of the stock in a Washington corporation known as the North Columbia Corporation.<sup>134</sup> The first corporation, Deer Park Pine Industry, acquired three-fourths of North Colum-

126. Survey, *supra* note 69, at 584-85 (quoting dictum *Sanford's Estate v. Commissioner*, 308 U.S. 39, 43 (1939)).

127. Specific examples of corporate and partnership real estate transfers resulting in past REET avoidance can be found *infra* part V.B.

128. *Estep v. King County*, 66 Wash. 2d 76, 401 P.2d 332 (1965).

129. 46 Wash. 2d 852, 286 P.2d 98 (1955).

130. *Id.* at 857, 286 P.2d at 100 (limiting REET liability, based on assumption of corporate debts, to the value of the realty transferred).

131. *Id.* at 860, 286 P.2d at 102.

132. *Estep*, 66 Wash. 2d 76, 401 P.2d 332; *Doric Co. v. King County*, 57 Wash. 2d 640, 358 P.2d 972 (1961); *Deer Park*, 46 Wash. 2d 852, 286 P.2d 98.

133. 46 Wash. 2d 852, 286 P.2d 98.

134. *Id.* at 853, 286 P.2d at 99.



bia's stock.<sup>135</sup> The second corporation, Chicago and Riverside Lumber Company, acquired the remaining one-fourth stock interest.<sup>136</sup> While the opinion does not provide an entire breakdown of the assets of North Columbia Corporation, it does note that the newly acquired stock represented certain real property.<sup>137</sup> Both acquisitions took place in March of 1950.<sup>138</sup>

In December of 1953, the shareholders of North Columbia Corporation resolved to liquidate the corporation.<sup>139</sup> Upon dissolution they quitclaimed the realty owned by North Columbia to its shareholders.<sup>140</sup> Based on the resulting real estate transaction, Stevens County assessed REET on Deer Park Pine Industry.<sup>141</sup> Deer Park Pine Industry subsequently filed suit to determine whether distribution of realty to the stockholders pursuant to liquidation was a taxable transaction.<sup>142</sup> A number of law firms filed a lengthy amicus curiae brief arguing two principal points.<sup>143</sup> First, the brief's authors argued that because nothing was bargained for by the stockholders who received the realty, the dissolution transaction did not constitute a "conveyance for valuable consideration."<sup>144</sup> Second, the brief's authors argued that title automatically vested in the shareholders after certain unilateral acts of the corporation. As such, the dissolution transaction was merely satisfaction of the shareholders' preexisting rights.<sup>145</sup>

In resolving the issue, the court looked specifically to the REET statute's definition of sale.<sup>146</sup> That definition contained two important phrases: "Sale shall have its ordinary meaning and shall in addition include any conveyance . . . for a valuable consideration."<sup>147</sup> After reviewing the statutory definition of sale the court concluded:

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135. *Id.*

136. *Id.*

137. *Id.*

138. *Deer Park*, 46 Wash. 2d at 853, 286 P.2d at 99.

139. *Id.*

140. *Id.* at 853-54, 286 P.2d at 99.

141. *Id.* at 854, 286 P.2d at 99.

142. *Id.*

143. Amicus Curiae Brief, *Deer Park Pine Industry, Inc. v. Stevens County*, 46 Wash. 2d 852, 286 P.2d 98 (No. 33201) (1955).

144. *Id.*

145. *Id.*

146. WASH. REV. CODE § 28A.45.010 (1955) (current version at WASH. REV. CODE § 82.45.010 (1989)).

147. *Id.*

The science of semantics would be stretched beyond permissible limits to conclude that the transaction under examination constitutes a sale in "its ordinary meaning." If the event is a taxable one, it must be such because it constitutes a "conveyance . . . for a valuable consideration."<sup>148</sup>

The court went on to state:

There is no conveyance for a valuable consideration . . . where a change of title to real property is effected solely as a result of its distribution to stockholders of a solvent corporation in the process of dissolution, *except as hereafter noted*. The change in title is but fruition of a right which accrued to the stockholder at the time the stock was acquired.<sup>149</sup>

The court then limited its determination by concluding that when the shareholders also accept the liabilities of the dissolving corporation, those liabilities constitute consideration.<sup>150</sup>

Because *Deer Park* was a case of first impression in Washington, and because no other state courts had addressed an analogous issue, the court turned to the somewhat similar federal documentary stamp tax<sup>151</sup> for guidance.<sup>152</sup> Specifically, the court relied heavily on two federal cases that considered whether a realty transfer through corporate dissolution constitutes a sale and a conveyance for consideration under the federal documentary stamp tax.<sup>153</sup> Those cases both held that when the stockholders assumed the liabilities of the liquidating corporation, the stamp tax was applicable to the extent of the liabilities assumed up to the value of the real property transferred.<sup>154</sup> As a result, the *Deer Park* court accepted that the assumption of a liquidating corporation's liabilities by its shareholders constitutes consideration within the definition of sale under RCW 82.45.010.<sup>155</sup> The amount of consideration transferred for determining the amount of tax due pursuant to the definition of "selling price" in RCW 82.45.030 is the value of

148. *Deer Park*, 46 Wash. 2d at 855, 286 P.2d at 100 (quoting WASH. REV. CODE § 28A.45.010 (1955)).

149. *Id.* at 857, 286 P.2d at 100 (citing *United States v. Niagara Hudson Power Corp.*, 53 F. Supp. 796, 801 (S.D.N.Y. 1944)) (emphasis added).

150. *Deer Park*, 46 Wash. 2d at 859, 286 P.2d at 102.

151. 26 U.S.C. §§ 3480, 3482 (1952) (repealed). The federal stamp tax was levied on instruments of writing that conveyed real estate to a purchaser. *Id.*

152. *Deer Park*, 46 Wash. 2d at 857-58, 286 P.2d at 101.

153. *Greyhound Corp. v. United States*, 208 F.2d 858 (7th Cir. 1954); *R.H. Macy & Co. v. United States*, 107 F. Supp. 833 (S.D.N.Y. 1952).

154. *Greyhound*, 208 F.2d at 860; *Macy*, 107 F. Supp. at 885.

155. *Deer Park*, 46 Wash. 2d at 859, 286 P.2d at 102.

the liabilities assumed.<sup>156</sup>

Although the *Deer Park* court upheld the tax in a corporate dissolution, it noted that the "[a]ssumption of the debts of a liquidating corporation by the stockholders is purely voluntary."<sup>157</sup> Thus, on the basis of this holding, the foundation was laid for the creation of a loophole. Namely, a person could avoid REET by buying the stock of a corporation and then dissolving the corporation to obtain the land, while not assuming any of the liquidating corporation's liability. Such a transaction was analyzed by the court in *Doric Co. v. King County*.<sup>158</sup>

### B. Step Two: Doric Co. v. King County

In *Doric*, the plaintiff acquired all of the outstanding stock of a corporation in 1958.<sup>159</sup> The sole asset of the newly acquired corporation was an apartment building in Seattle known as the Grosvenor House.<sup>160</sup> When the plaintiff acquired the Grosvenor House, it was valued at \$5,100,000 and was encumbered by a mortgage securing a \$2,550,000 note.<sup>161</sup>

In that same year, proceedings for dissolution of the corporation were commenced by the plaintiff as the sole stockholder, and a trustee was appointed to proceed with the dissolution.<sup>162</sup> As a result of that dissolution, the plaintiff received a warranty deed to the Grosvenor House.<sup>163</sup> Although the warranty deed contained a statement that the "property is conveyed subject to a lien of real property mortgage executed by . . . [the corporation as mortgagor to the mortgagee,]" the plaintiff did not assume the mortgage obligation.<sup>164</sup> The mortgagee was never notified of the dissolution; after distribution, the plaintiff made all the payments on the note out of income from the operation of the Grosvenor House.<sup>165</sup>

King County assessed REET on the transfer to the plaintiff, arguing that *Deer Park* made it implicit that a stockholder agrees to assume the corporate liabilities due to the very

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156. WASH. REV. CODE § 82.45.030 (1989).

157. *Deer Park*, 46 Wash. 2d at 859, 286 P.2d at 102.

158. 57 Wash. 2d 640, 358 P.2d 972 (1961).

159. *Id.* at 642, 358 P.2d at 973.

160. *Id.*

161. *Id.*

162. *Id.*

163. *Doric*, 57 Wash. 2d at 642, 358 P.2d at 973.

164. *Id.* at 642-43, 358 P.2d at 973.

165. *Id.* at 643, 358 P.2d at 973.

nature of a distribution of assets in furtherance of dissolution.<sup>166</sup> Although the *Doric* court accepted that *Deer Park* governed the case, it disagreed with King County. The court stated as follows:

We are not willing to depart from this reasoning [in *Deer Park*]. We found the distribution in the *Deer Park* case was a taxable event because the stockholders had agreed by contract to assume the corporate liabilities in consideration for the trustee's undertaking to distribute [to them] the corporate assets in kind. . . . Unlike the *Deer Park* case, the instant case contains no agreement by the stockholders to assume any corporate liabilities.<sup>167</sup>

Therefore, based on the reasoning in *Deer Park*, and because the plaintiff had not accepted any of the corporation's liabilities, the Grosvenor House was transferred to the plaintiff without incurring REET liability.<sup>168</sup> Using *Deer Park's* foundation for a loophole, the court in *Doric* continued the building process. Only one case remained before the court would totally disregard a REET transaction's substance by looking solely to the transaction's form.

### C. Step Three: *Estep v. King County*

*Estep v. King County*<sup>169</sup> is the final case in the corporate loophole trilogy. In *Estep*, a corporation's stockholders contracted and sold all of their stock to the plaintiffs.<sup>170</sup> The purchase price of the stock was payable in installments over a number of years.<sup>171</sup> Less than three months later, the plaintiffs, as shareholders, voted to dissolve their newly purchased corporation and appointed a statutory liquidating trustee.<sup>172</sup> That trustee, in turn, dissolved the corporation and presented the shareholders with a quitclaim deed for the realty owned by the newly purchased corporation.<sup>173</sup> Upon presentation of the deed to King County for recording, the county assessed REET on the sale.<sup>174</sup> The shareholders paid the tax in protest and

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166. *Id.* at 645, 358 P.2d at 975.

167. *Id.* at 645, 358 P.2d at 974.

168. *Doric*, 57 Wash. 2d at 646, 358 P.2d at 975.

169. 66 Wash. 2d 76, 401 P.2d 332 (1965).

170. *Id.* at 77, 401 P.2d at 333.

171. *Id.*

172. *Id.*

173. *Id.*

174. *Estep*, 66 Wash. 2d at 78, 401 P.2d at 333.

commenced a refund action.<sup>175</sup>

The county claimed that despite *Deer Park* and *Doric*, the *Estep* transaction was distinguishable and, thus, taxable.<sup>176</sup> The shareholders originally acquired the corporation's shares for the purpose of transferring the real estate. Less than three months later, the shareholders dissolved the corporation to avoid the real estate excise tax.<sup>177</sup> The county claimed that it would be error for the court not to recognize the two separate transactions as a single transaction for the sale of real estate.<sup>178</sup> In support of their argument, the county relied on the Kimbell-Diamond rule,<sup>179</sup> as explained in *United States v. Mattison*.<sup>180</sup>

When a taxpayer who is interested primarily in a corporation's assets first purchases the stock and then liquidates the corporation in order to acquire the desired assets, the separate steps taken to accomplish the primary objective will be treated as a single objective. Thus, even though the objective was accomplished in form by a purchase of stock, the substance of the transaction is a purchase of property.<sup>181</sup>

The court, however, declined to adopt the Kimble-Diamond rule for real estate transactions. Specifically, the court declined on the basis that the rule would require the counties and courts to search for subjective intent every time a transfer of stock was followed by a transfer of real property during corporate dissolution.<sup>182</sup> The court further stated that if any future change in the application of the REET statute was to occur, it would have to be by legislative mandate.<sup>183</sup>

While *Estep* took *Deer Park* to its limit, Justice Finley dissented. Justice Finley expressed his concern that complex corporate principles were being used to interpret a statute that defines a taxable sale as a sale within the "ordinary mean-

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175. *Id.*

176. *Id.* at 79, 401 P.2d at 334.

177. *Id.* at 77, 401 P.2d at 333.

178. *Id.* at 79, 401 P.2d at 334.

179. *Estep*, 66 Wash. 2d at 79, 401 P.2d at 334 (citing M. L. Cross, Annotation, *Income Tax: Corporate Assets as Received in Liquidation or by Purchase Where Stock is Purchased to Acquire Assets*, 83 A.L.R.2d 718 (1962)).

180. 273 F.2d 13 (9th Cir. 1959).

181. *Estep*, 66 Wash. 2d at 79, 401 P.2d at 334 (citing *United States v. Mattison*, 273 F.2d 13 (9th Cir. 1959)).

182. *Id.* at 80, 401 P.2d at 334.

183. *Id.* at 80, 401 P.2d at 335.

ing"<sup>184</sup> of the term.<sup>185</sup> And "when an incorporator has sold his stock to another party who receives land upon the dissolution of the corporation . . . there has been a sale within the ordinary meaning of that term."<sup>186</sup> Nevertheless, the majority in *Estep* disagreed and concluded that the transfer of ownership was not subject to REET. The loophole was complete and it would only take time to realize it.

*D. After the Fact Affirmation: Ban-Mac Inc. v. King County and Weaver v. King County*

While King County received a supportive vote in Justice Finley's dissent, the County nonetheless lost the battle in *Estep*. However, King County was not prepared to accept that the *Estep* court's reasoning left an obvious loophole in its wake. Instead, King County returned to the Washington State Supreme Court twice more to litigate the issue.<sup>187</sup> And both times, King County was unsuccessful.

King County's first attempt to find a way around *Deer Park*, as stated in *Estep*, was *Ban-Mac Inc. v. King County*.<sup>188</sup> While King County asserted that the facts in *Ban-Mac* were sufficiently different from previous cases, the court disagreed. In fact, the court found the facts presented in *Ban-Mac* so inconsequential to its affirmation of the *Deer Park* rationale, that the opinion expressly forgoes mentioning any of those facts.<sup>189</sup> Nevertheless, in reaching its judgment in *Ban-Mac*, the court finally acknowledged that as a result of *Deer Park* and its progeny,<sup>190</sup> there was an obvious means to avoid REET on certain real estate transactions:

As the law now stands, a sizeable loophole exists when a person buys the stock of an existing corporation and then dissolves the corporation to obtain the land. However, this

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184. WASH. REV. CODE § 82.45.010 (1989) (defining the term "sale" for REET purposes as having its "ordinary meaning").

185. *Estep*, 66 Wash. 2d at 80, 401 P.2d at 335 (Finley, J., dissenting).

186. *Id.*

187. *Weaver v. King County*, 73 Wash. 2d 183, 437 P.2d 698 (1968); *Ban-Mac, Inc. v. King County*, 69 Wash. 2d 49, 416 P.2d 694 (1966).

188. 69 Wash. 2d 49, 416 P.2d 694 (1966).

189. *Id.* at 50, 416 P.2d at 695. For the purposes of this discussion, those facts are not important either.

190. *Christensen v. Skagit County*, 66 Wash. 2d 95, 401 P.2d 335 (1965); *Estep v. King County*, 66 Wash. 2d 76, 401 P.2d 332 (1965); *Doric Co. v. King County*, 57 Wash. 2d 640, 358 P.2d 972 (1961); *Deer Park Pine Industry, Inc. v. Stevens County*, 46 Wash. 2d 852, 286 P.2d 98 (1955).

loophole may be of minimal importance, and it is possible that this exception has been purposefully left on the books by the legislature. *Deer Park* was handed down in 1955, and the legislature has done nothing to the statute [since then]. . . .<sup>191</sup>

Despite acknowledging the loophole, the *Ban-Mac* court refused to grant King County's request to judicially close the loophole. The court concluded that because the legislature had not amended the REET statute in the eleven years following *Deer Park*, the legislature's inaction was tantamount to acquiescence of the newly created loophole.<sup>192</sup> Moreover, because the Washington State Constitution<sup>193</sup> places taxation matters within the province of the legislature, the court concluded that to overrule *Deer Park* would violate the separation of powers doctrine.<sup>194</sup>

After *Ban-Mac*, King County made one final assault on *Deer Park* in *Weaver v. King County*.<sup>195</sup> Once again, the court refused the county's request to tax the actual substance of a corporate real estate transaction, stating that any future reversal of the *Deer Park* rationale would be left to legislative action.<sup>196</sup> The court also refused King County's newly formulated argument that was based on the specific facts of *Weaver*.<sup>197</sup>

In *Weaver*, the realty in question was valued at \$400,000 and was encumbered by a mortgage with an unpaid balance of \$46,000.<sup>198</sup> That realty was acquired by the grantee as an asset of a newly acquired corporation.<sup>199</sup> Six months after this acquisition, the grantee decided to dissolve the newly acquired corporation.<sup>200</sup> As a result, the liquidating trustee of the corporation delivered to the grantee a statutory warranty deed conveying the realty subject to the unpaid mortgage.<sup>201</sup> King

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191. *Ban-Mac*, 69 Wash. 2d at 51, 416 P.2d at 695.

192. *Id.*

193. WASH. CONST., art. VII, § 1.

194. *Ban-Mac*, 69 Wash. 2d at 51, 416 P.2d at 695. Today, the validity of such an argument may be questioned in light of recent legislative efforts to close the loophole created by the court in *Deer Park*. See *infra* Part VI for an overview of recent legislative efforts to close the *Deer Park* loophole.

195. 73 Wash. 2d 183, 437 P.2d 698 (1968).

196. *Id.* at 184 n.1, 437 P.2d at 699 n.1.

197. *Id.* at 186, 437 P.2d at 700.

198. *Id.* at 185, 437 P.2d at 700.

199. *Id.*

200. *Weaver*, 73 Wash. 2d at 185, 437 P.2d at 700.

201. *Id.*

County argued that if the court would not alter its position from *Deer Park*, it should at least find the transaction taxable to the extent that the grantee took the property "subject to" a mortgage of \$46,000.<sup>202</sup> The court, however, disagreed and stated as follows:

The grantee of a deed is not bound by the mortgagor's covenant binding himself and his successors to pay the mortgage debt, even though the mortgage declares that the covenant runs with the land, unless the grantee has, in some way other than mere acceptance of the deed, assumed the mortgage indebtedness.<sup>203</sup>

After *Weaver*, King County gave up on the court; it was obvious that the legislature would be its sole refuge.

#### *E. An Added Twist: Christensen v. Skagit County*

After studying the court's treatment of REET in the context of corporate dissolution proceedings, one begins to feel that any real estate transaction involving a corporation is free from REET liability. However, the court maintained one obstacle to total REET avoidance. In *Christensen v. Skagit County*,<sup>204</sup> the court ruled that while a dissolving corporation could transfer realty tax free, realty transferred into a newly created corporation in exchange for corporate stock was taxable.<sup>205</sup>

The plaintiffs in *Christensen* were three partners who owned three separate supermarkets.<sup>206</sup> Desiring to do business in corporate form, the partners organized three separate corporations and transferred all of the partnership assets, including the real property, to the corporations.<sup>207</sup> In each instance, the partners were the only incorporators and the only shareholders.<sup>208</sup> Once the transaction was complete, Skagit County required REET payment before the county would record the deeds conveying the real property.<sup>209</sup> The plaintiffs paid under protest and filed suit to recover the tax paid.<sup>210</sup> "The only

202. *Id.*

203. *Id.* at 186, 437 P.2d at 700-01.

204. 66 Wash. 2d 95, 401 P.2d 335 (1965).

205. *Id.* at 97-98, 401 P.2d at 337.

206. *Id.* at 95, 401 P.2d at 336.

207. *Id.*

208. *Id.*

209. *Christensen*, 66 Wash. 2d at 95-96, 401 P.2d at 336.

210. *Id.*



[issue was] whether the . . . tax applie[d] to conveyances of real property by members of a partnership to a corporation in return for the issuance of corporate stock."<sup>211</sup>

The *Christensen* court recognized that the issue, as in *Deer Park* and its progeny, was whether a "sale" for REET purposes included the transfer in question.<sup>212</sup> Because the *Christensen* plaintiffs saw their transaction as the inverse of the *Doric* transfer, in which a dissolving corporation transferred realty to a partnership tax free, they claimed by inverse analogy that they did not owe the tax.<sup>213</sup> The court refuted the argument, stating:

Even though it might be said that the transfer of real property to a corporation in return for stock is at the opposite end of the spectrum from a transfer of real property by a liquidating trustee to the shareholders [the *Deer Park* transaction], there the analogy ends. Each transaction is based on a different legal theory.<sup>214</sup>

The *Christensen* court also disagreed that a transfer of real property from a partnership to a corporation was merely "taking it out of one pocket and putting it in another."<sup>215</sup> Instead, the court concluded that the newly formed corporations were separate organizations with different privileges and liabilities from those enjoyed by the plaintiffs prior to incorporation.<sup>216</sup> The court further concluded that the transaction was a sale for "a valuable consideration," because the partnership sold its real property for "the right to do business in the corporate

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211. *Id.* at 96, 401 P.2d at 336.

212. *Id.*

213. *Id.* at 97, 401 P.2d at 337. The same assumption was made in a law review Note following *Deer Park*. See Conger, *supra* note 124, at 225 n.30. That article stated:

It was decided in *Deer Park* that when a corporation is dissolved, the termination of the rights incident to the ownership of stock was not "consideration" for the right to direct ownership of the asset by distribution. . . . The court may well determine, based upon this that the reverse procedure should be treated in the same fashion: that is, that the termination of direct ownership in an asset is not "consideration" for the rights incident to the ownership of stock received by the individual, and thus no taxable "sale" occurred.

This same passage is used as support in Justice Finley's dissent in *Christensen*, 66 Wash. 2d at 99, 401 P.2d at 338 (dissenting opinion discussed *infra* text accompanying notes 224-28).

214. *Christensen*, 66 Wash. 2d at 98, 401 P.2d at 337.

215. *Id.*

216. *Id.*

form."<sup>217</sup>

Justice Finley maintained the philosophy he espoused in *Estep*, stating that the *Christensen* court had once again missed the true mandate of the tax due to the "color of *Deer Park* . . . and . . . *Doric*."<sup>218</sup> Justice Finley believed that a taxable transaction was meant to be a "transfer of the ownership"<sup>219</sup> and that in *Christensen* no transfer had truly taken place. Justice Finley also declined to accept the majority's position that the right to do business in corporate form constituted "a valuable consideration."<sup>220</sup> Justice Finley recognized that if *Christensen*-type transactions were not taxable, then the tax could be completely avoided.<sup>221</sup> However, Justice Finley felt that the underlying problem was *Deer Park* and its progeny, not *Christensen*-type transactions.<sup>222</sup> And, as we shall see in the following pages, Justice Finley's position was sound.

The holding in *Christensen* does appear to be inconsistent with *Deer Park* and its progeny,<sup>223</sup> just as Justice Hale pointed out in his dissent in *Weaver v. King County*:<sup>224</sup>

*Christensen v. King County* . . . in my opinion, departed from the rationale of the earlier cases and thus cast some doubt on *Deer Park* and its successors. . . . In my mind, however, the rationale of *Christensen* comes closer to carrying out the intention of the legislature than do the other cases. The issues, as I see them, are quite simple. . . . If the transfers are for a valuable consideration, they are taxable sales under the pertinent statutes . . . .<sup>225</sup> [Both a] transfer of real estate from a dissolved corporation to its stockholders [like in *Deer Park* and its progeny], . . . or from partners to a corporation in which the grantor will own the capital stock [like in *Christensen*] . . . appear to me abundantly supported by consideration and should be held taxable as a sale of real

217. *Id.* at 98, 401 P.2d at 337.

218. *Id.* at 99, 401 P.2d at 338 (Finley, J., dissenting).

219. *Christensen*, 66 Wash. 2d at 99, 401 P.2d at 338; see WASH. REV. CODE § 82.45.010 (1989).

220. *Christensen*, 66 Wash. 2d at 99, 401 P.2d at 338.

221. *Id.* at 102, 401 P.2d at 339. For example, Able, a landowner, could incorporate and transfer his realty to a newly-created corporation in which he owns one hundred percent of the stock. Then, Able could sell his stock in the corporation to Buyer, who would later dissolve the corporation and receive the realty without REET liability.

222. *Id.*

223. See cases cited *supra* note 190.

224. 73 Wash. 2d 183, 187, 437 P.2d 698, 701 (1968) (Hale, J., dissenting) (majority opinion discussed *supra* in text accompanying notes 195-203).

225. *Id.* at 187-88, 437 P.2d at 701.

estate . . . .<sup>226</sup> I see no difference in principal as far as the doctrine of consideration is concerned between conveyances to or from newly organized corporations and conveyances from a dissolving one. . . .<sup>227</sup>

However, while the opinion in *Christensen* may have been inconsistent with *Deer Park*, the court had little choice but to find the *Christensen* transaction taxable. As Justice Finley pointed out in his dissent, had the *Christensen* court not upheld the tax, the tax could have been completely avoided. Although the court could have overruled *Deer Park*, as we have seen, it was far from willing to do so. And while the inconsistency between *Christensen* and *Deer Park* brought *Deer Park*'s rationale into question, the court refused to overturn *Deer Park* in future cases.<sup>228</sup>

## V. PROBLEMS ON REET STREET

The *Christensen* court upheld REET on the transfer of real estate to a corporation in exchange for stock.<sup>229</sup> Significantly, the transaction in *Christensen* was taxable precisely because corporate stock was exchanged for realty.<sup>230</sup> In some cases, however, stock need not be exchanged for real estate in a single transaction. Rather, one can avoid REET liability as applied in *Christensen* through a two-step transaction.

Consider the following two-step transaction. Able is a landowner who desires to transfer his personal real estate ownership to a corporation. Able creates a corporation and registers one hundred percent of the corporate stock in his name. Able then transfers his real estate to his corporation as a capital contribution. Able receives no stock in return for the transaction; hence, Able exchanged no consideration for the realty, and the transaction is not taxable.<sup>231</sup> Note, however, that Able is the sole stockholder of the corporation. Conse-

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226. *Id.* at 189, 437 P.2d at 702.

227. *Id.* at 190, 437 P.2d at 703.

228. *See, e.g., Weaver*, 73 Wash. 2d 183, 437 P.2d 698; *Ban-Mac, Inc. v. King County*, 69 Wash. 2d 49; 416 P.2d 694 (1966).

229. *Christensen v. Skagit County*, 66 Wash. 2d 95, 98, 401 P.2d 335, 337 (1965).

230. *Id.* at 97, 401 P.2d at 336.

231. *See* WASH. REV. CODE § 82.45.010 (1989); *see also* 63-64 Op. Att'y Gen. 44 (1963), *aff'd*, 77 Op. Att'y Gen. 6 (1977) (ruling that a capital contribution of real estate to a corporation is not a REET taxable transaction); *cf.* Adopted Regulation, 1990 N.Y. Tax LEXIS 523, at \*4 (N.Y. Comm'r Tax & Fin. Oct. 22, 1990) (stating that pursuant to New York State's Realty Transfer Tax, the following rule applies to partnerships: "A conveyance by a partner to the partnership as a contribution of partnership assets is

quently, Able owns one hundred percent of the stock in a corporation that includes Able's previously owned real estate as an asset. Thus, by transferring his realty as a capital contribution, Able incurred no REET liability despite the hurdle created in *Christensen*.

### A. Troubleshooting the Underlying Problem

*Deer Park* and its progeny make clear that a transfer of real estate from a corporation to its shareholders in dissolution is not a taxable transaction. These cases also stand for the proposition that corporate stock transfers are not subject to REET even if the stock represents only realty assets.<sup>232</sup>

In addition, according to the Department of Revenue, the transfer of a partnership interest is not a real property transaction.<sup>233</sup> Therefore, realty can be transferred either in corporate or partnership form with unlimited shelter from REET.<sup>234</sup> For example, "a corporation largely made of timber land can be readily sold and resold without taxation."<sup>235</sup>

Under *Christensen*, incorporating and transferring realty into the corporation in exchange for stock is a taxable transaction.<sup>236</sup> But, as just illustrated, it is not difficult to circumvent *Christensen*'s holding simply by transferring the realty to the corporation as a capital contribution without directly receiving stock. The end result is that a sophisticated party can easily transfer realty using a corporation as the transfer vehicle and completely avoid REET on the realty sale. Creating a corporation is an inexpensive process. As an incentive for a buyer to purchase property through corporate stock, rather than simply by deed, a seller can agree to share the resulting tax savings by lowering the realty's price.

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subject to tax to the extent that there is a change in beneficial ownership"). An analysis of New York State's Realty Transfer Tax can be found *infra* part VII.A.

232. See *Estep v. King County*, 66 Wash. 2d 76, 401 P.2d 332 (1965); *Doric Co. v. King County*, 57 Wash. 2d 640, 358 P.2d 972 (1961); *Deer Park Pine Industry, Inc.*, 46 Wash. 2d 852, 286 P.2d 98 (1955); see also 51-53 Op. Att'y Gen. 158 (1951).

233. WASH. ADMIN. CODE § 458-61-570 (1990) (interpreting 51-53 Op. Att'y Gen. 158 (1951) to include both transfers of corporate stock and partnership interests as transfers of personal property).

234. See *id.*

235. *Christensen v. Skagit County*, 66 Wash. 2d 95, 102, 401 P.2d 335, 340 (1966) (Finley, J., dissenting).

236. *Id.* at 98, 401 P.2d at 337.

### B. A Few Specific Examples

Following are three subtly different transactions resulting in REET avoidance. Each transaction is protected from REET liability under *Deer Park* and its progeny.<sup>237</sup>

A parent corporation forms a subsidiary and receives the subsidiary's stock in exchange for both real and personal property. Although stock is received in exchange for realty, the parent corporation can avoid REET liability despite *Christensen*<sup>238</sup> by claiming that they exchanged the stock solely for the personal property transferred, and that the real estate was transferred to the subsidiary as a capital contribution.<sup>239</sup> As a result, the sale does not incur REET liability.<sup>240</sup>

Mergers can also result in REET avoidance. For example, one large corporation acquires the stock of several smaller corporations, each with assets that include several parcels of Washington State real estate. Each of the smaller corporations are merged into a single subsidiary of the large corporation. As a result, all of the real estate is transferred into the large corporation's subsidiary, but no REET liability is incurred.<sup>241</sup>

Finally, like corporate transfers and mergers, transfers involving partnerships may take many forms that avoid REET. For example, a buyer and a seller join together as partners to complete a real estate transaction. The seller contributes real estate to the partnership as a capital contribution, thus avoiding REET liability. The buyer contributes cash to the partnership equal to the real estate selling price. Next, the seller takes distribution of the cash and retires as a partner. Upon the seller's retirement, the partnership terminates, leaving the buyer as the owner of the real estate without incurring REET liability.

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237. See cases cited *supra* note 190.

238. *Christensen*, 66 Wash. 2d 95, 401 P.2d 335 (holding that real estate transferred in exchange for corporate stock is a taxable transaction); see discussion *supra* part IV.E.

239. See 63-64 Op. Att'y Gen. 44 (1963) (ruling that contributions to capital do not constitute taxable sales for REET purposes).

240. 3 Washington Tax Determination 259 (1987).

241. This scenario is further complicated due to legislation passed during the 1991 session. That legislation permits the merger of two or more limited partnerships and the merger of limited partnerships and corporations. 1991 Wash. Laws 269.

## VI. THE REET STREET PLANNERS RETURN: RECENT LEGISLATIVE ATTEMPTS TO SOLVE THE REET STREET PROBLEM

While it may have taken several cases to verify the court's acknowledgement of the loophole created by *Deer Park*, the court in *Ban-Mac* expressly recognized its existence.<sup>242</sup> Indeed, the majority in both *Ban-Mac* and *Weaver* concluded that the lack of legislative intervention in the years following *Deer Park* condoned *Deer Park*'s rationale.<sup>243</sup> Today, however, it is clear that the legislature is seriously grappling with how to close the partnership and corporate transfer loophole.

### *A. Partnerships and Corporations After the 1991 Corporate Transfer Act*<sup>244</sup>

In 1991, the Washington State Legislature made its first attempt to close the loophole created in *Deer Park*.<sup>245</sup> Through the 1991 Corporate Transfer Act, the legislature clearly evidenced its intent to eliminate the judicially created inequities under REET. The 1991 legislation, however, also made it clear that accomplishing this task is easier said than done. Below are a few examples of new concerns created by the 1991 legislation.

The 1991 Corporate Transfer Act created a new chapter in the Revised Code of Washington entitled "Excise Tax on Ownership Transfer of a Corporation."<sup>246</sup> The new chapter, RCW 82.45A, aims at solving the corporation transfer loophole by

242. *Ban-Mac, Inc. v. King County*, 69 Wash. 2d 49, 51, 416 P.2d 694, 695 (1966).

243. *Weaver v. King County*, 73 Wash. 2d 183, 184 n.1, 437 P.2d 698, 699 n.1 (1968); *Ban-Mac*, 69 Wash. 2d at 51, 416 P.2d at 695. In *Weaver*, Justices Hale and Finley were not as confident as their colleagues. They disagreed that simply because the legislature had failed to amend REET, it meant that the legislature would remain content with the effects of *Deer Park*. As Justice Hale stated in his dissent: "[W]e can derive little comfort from the often but wistfully expressed notion that the legislature will soon see our error and correct it. In many instances, this legislative remedy simply does not take place. . . ." *Weaver*, 73 Wash. 2d at 193, 437 P.2d at 704.

244. In 1981, the legislature first amended the REET statute to specifically address a transfer made in corporate or partnership form. WASH. REV. CODE § 82.45.010 (1989) (enacted as 1981 Wash. Laws 93). That amendment provided an exemption to promote family-held corporation transfers, thereby facilitating inter-family non-taxable, non-gift transactions. However, despite the 1981 legislation's appearance, it was not passed to remedy the *Deer Park* decision. Instead, the exemption appears to have been for estate planning purposes. Therefore, the first attempt to repair REET was not made until 1991. Corporate Transfer Act, 1991 Wash. Laws 1st Spec. Sess. 22.

245. Corporate Transfer Act, 1991 Wash. Laws 1st Spec. Sess. 22 (codifying engrossed substitute house bill (ESHB) 1831).

246. WASH. REV. CODE ch. 82.45A (Supp. 1990-91).

treating changes in corporate real estate ownership as the equivalent to realty sales.<sup>247</sup> It is important to recognize, however, that while RCW Chapter 82.45A is aimed at addressing the corporate transfer REET loophole, RCW Chapter 82.45A is not a new section of REET.<sup>248</sup> Rather, RCW Chapter 82.45A is a separate tax imposed on an "ownership transfer of a corporation."<sup>249</sup>

RCW Chapter 82.45A is composed of three sections. The first section merely provides definitions. In particular, this section defines an "ownership transfer" as "any transfer, or series of transfers in any consecutive twelve-month period, for a valuable consideration, of ownership of stock, possessing more than fifty percent of the total voting power of the issue. . . ."<sup>250</sup> The second section<sup>251</sup> imposes the tax on "each *ownership transfer* of a corporation, to be paid by the corporation, at the rate of one and twenty-eight one-hundredths percent<sup>252</sup> of the value of the real property assets of the corporation."<sup>253</sup> And the third section provides a list of exemptions from the tax.<sup>254</sup>

Notably, several of these enumerated exemptions are also exempt from noncorporate REET liability pursuant to RCW 82.45.010.<sup>255</sup> However, the following three newly created ownership transfer exemptions<sup>256</sup> are worthy of noting because each significantly impairs the utility of the 1991 Corporate Transfer Act.<sup>257</sup>

### 1. RCW 82.45A.030 Exemptions: What Do They Really Mean?

Some of the most noticeable problems with the 1991 Corporate Transfer Act are created by the statutory exemptions.<sup>258</sup> While these exemptions are driven by unique policy considera-

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247. *Id.* § 82.45A.020.

248. *See id.* § 82.45A.020; *cf. id.* § 82.45.060 (1989).

249. *See id.* § 82.45A.020 (Supp. 1990-91).

250. WASH. REV. CODE § 82.45A.010 (Supp. 1990-91).

251. *Id.* § 82.45A.020.

252. This rate is equivalent to that imposed for noncorporate REET transactions pursuant to *id.* § 82.45.060 (1989).

253. *Id.* § 82.45A.020 (Supp. 1990-91) (emphasis added).

254. *Id.* § 82.45A.30.

255. WASH. REV. CODE § 82.45A.030(4), (5), (8) (Supp. 1990-91); *cf. id.* § 82.45.010 (1989).

256. *See id.* § 82.45A.030(1), (2), (6) (Supp. 1990-91).

257. *Id.* ch. 82.45A.

258. *Id.* § 82.45A.030(1)-(6).

tions surrounding corporate transfers, they nevertheless create significant doubt as to the applicability of the newly passed legislation.

*a. RCW 82.45A.030(1): Adding Subjective Intent to an Objective Area of Law*

REET is based on the objective principle that when a sale as defined by RCW 82.45.010 takes place, it is subject to REET liability without regard to the seller's purpose for making the sale.<sup>259</sup> However, the first exemption to the 1991 Corporate Transfer Act is based on the subjective intent of the seller.<sup>260</sup> As a result, the tax does not apply to ownership transfers "[w]hen the taxpayer demonstrates by a preponderance of the evidence that the primary intent of the ownership transfer is for purposes other than avoidance of the tax imposed in chapter 82.45 RCW."<sup>261</sup>

There clearly are, however, difficulties inherent in determining the primary intent behind a corporate stock ownership transfer. For instance, the burden of determining the primary intent of a corporate transaction motivated the Washington State Supreme Court to refuse to apply the Kimbell-Diamond rule to a two-step transaction in *Estep*.<sup>262</sup> That court stated: "Adoption of the rule . . . would involve the county and the courts in a search for subjective intents, motives, and purposes every time a transfer of stock is followed by a transfer of real property. . . ." <sup>263</sup>

In addition, the primary intent exception<sup>264</sup> makes it impossible for the Department of Revenue to promulgate standards dictating when a transaction is taxable. Instead, the tax liability of each transaction will require a factual determination of the seller's primary motivations. Because several factors might motivate a seller, determining a seller's primary motivation is difficult. For example, because of the large discrepancy between the maximum federal income tax rate for corporations (34%)<sup>265</sup> and the REET rate (1.28%),<sup>266</sup> a taxpayer

259. See WASH. REV. CODE § 82.45.010 (1989).

260. See *id.* § 82.45A.030(1) (Supp. 1990-91)

261. *Id.*

262. *Estep v. King County*, 66 Wash. 2d 76, 401 P.2d 332 (1965). See discussion *supra* part IV.C.

263. *Estep*, 66 Wash. 2d at 80, 401 P.2d at 334.

264. WASH. REV. CODE § 82.45A.030(1) (Supp. 1990-91).

265. I.R.C. § 11(c) (1988).



could be primarily motivated by a desire to save federal taxes. In the end, the difficulty of quantifying a seller's subjective intent will impair a taxpayer's ability to plan transactions with any certainty.

*b. RCW 82.45A.030(2): The Burden of Showing the Value of Real Property Assets*

The second exemption from the tax imposed by the 1991 Corporate Transfer Act applies to ownership transfers "[w]hen the value of real property assets of the corporation is less than fifty percent of the true and fair market value in money of all assets held by the corporation at the time of the ownership transfer."<sup>267</sup> The problem with this exemption is that it places an undue burden on the seller of corporate assets to know the fair market value of all the corporate assets at the time of an ownership transfer. While an appraisal could be performed at the time of an ownership transfer to determine if the exemption applies, such a prerequisite is overly burdensome. Furthermore, the statute fails to provide sufficient direction for a taxpayer to perform such an appraisal. For example, a taxpayer could include the value of intangibles, such as good will, in the total value of the corporation. By doing so, the taxpayer could inflate the value of the corporation's assets above the threshold to qualify for the exemption provided by RCW 82.45A.030(2).<sup>268</sup> The statute, however, is not clear whether such practices are consistent with the legislation's intent.

*c. RCW 82.45A.030(6): What About Using Leverage?*

A third and final exemption poses unique questions pertaining to the 1991 Corporate Transfer Act. This exemption provides that the tax does not apply to ownership transfers "[s]olely for the purpose of securing a debt."<sup>269</sup> This exemption has merit when considering the desirability of not restricting corporate opportunities to finance operating capital. The exemption also provides shelter from the tax in instances of corporate reorganization for bankruptcy purposes. However, while the exemption has some merit, it also creates an additional opportunity to avoid the tax.

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266. WASH. REV. CODE § 82.45A.020 (Supp. 1990-91).

267. *Id.* § 82.45A.030(2).

268. *Id.*

269. *Id.* § 82.45A.030(6).

Because an ownership transfer solely for the purpose of securing a debt is not taxable, a taxpayer could avoid the tax through the following transaction: First, Able Corp. could mortgage corporate-owned realty to Buyer for one hundred percent of its value. The mortgage would be secured by a deed of trust to the realty. The Buyer could then foreclose on the mortgage. Consequently, Able Corp. would receive one hundred percent of the property's value in cash while avoiding REET, and Buyer would receive title to the property.

## 2. Returning to Real Property: Mining Leases

Moving away from the exemptions, RCW Chapter 82.45A raises additional questions as to the viability of the 1991 Corporate Transfer Act.

The 1991 Corporate Transfer Act imposes a tax on an "ownership transfer"<sup>270</sup> only if at least fifty percent of the transferred corporation's asset value is based on *real property*.<sup>271</sup> It would seem that REET should treat both corporate and individual transactions the same. However, the following scenario concerning mining leases suggests that the Corporate Transfer Act<sup>272</sup> yields a different result for corporations than REET does for individuals.<sup>273</sup>

Most real estate transactions do not bring into question whether the property transferred is real or personal. However, as discussed earlier in the context of standing timber,<sup>274</sup> there are particular transactions where uncertainty regarding whether property is real or personal raises questions as to REET liability. For example, a transfer in fee of mineral rights in private land is a transfer of real property and is, therefore, subject to REET pursuant to RCW Chapter 82.45.<sup>275</sup> However, according to the Attorney General, unpatented mining claims appurtenant to public lands are personal property and, as such, are not covered by REET.<sup>276</sup>

RCW 82.45.010 excludes a transfer of any leasehold, other than a lease containing an option to purchase, from REET.<sup>277</sup>

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270. WASH. REV. CODE § 82.45A.010(1) (Supp. 1990- 91).

271. *Id.* § 82.45A.020(2) (emphasis added).

272. *Id.* ch. 82.45A.

273. *Id.* ch. 82.45 (1989).

274. See discussion *supra* part III.B.3.

275. WASH. REV. CODE § 82.45 (1989).

276. 51-53 Op. Att'y Gen. 408 (1953); 55-57 Op. Att'y Gen. 84 (1954).

277. WASH. REV. CODE § 82.45.010 (1989).

Because any ambiguity concerning a tax exemption is narrowly construed, with taxation as the rule and exemption as the exception,<sup>278</sup> it would seem that the expressed exception for leaseholds would not include a mineral lease that, in a sense, grants the lessee any extracted mineral component of an estate in fee. It also seems inconsistent not to tax mineral leases when the lessee typically is required to pay a royalty to a lessor upon severance of mineral ore from the property equal to some measure of the mineral value extracted.

However, the Washington State Department of Revenue has relied on various authorities to conclude that a mineral lease, with no option to purchase, is not subject to REET liability under RCW Chapter 82.45. First, is *Hoover v. Ford Prairie Coal Co.*<sup>279</sup> where the court held that an agreement granting the right to enter property to mine coal in exchange for the payment of royalties was a valid "lease."<sup>280</sup> Second, is RCW 82.45.010, which exempts from REET the conveyance of "any" leasehold, except with an option to purchase real property.<sup>281</sup> Thus, relying on these principles the Department of Revenue has determined that a mining lease, void of a purchase option, is not subject to REET liability under RCW Chapter 82.45.

While the department has determined that a mineral lease without a purchase option is not subject to REET because of the lease exception in RCW 82.45.010, the department could treat the same transaction differently for RCW Chapter 82.45A purposes. Instead, the department could find that a mining lease, with or without an option to purchase, constitutes real property.<sup>282</sup> Such a position would not change the department's stance regarding the taxability of mining leases pursuant to RCW Chapter 82.45, because RCW 82.45.010 expressly excepts all leases that do not have an option to purchase from the definition of a taxable sale. However, no such exception exists in RCW Chapter 82.45A. As a result, the transfer of a mineral lease, without an option to purchase, could be a taxable transfer of real property when performed by a corporation

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278. *Budget Rent-a-Car v. Dep't of Revenue*, 81 Wash. 2d 171, 174, 500 P.2d 764, 766 (1972).

279. 145 Wash. 295, 259 P. 1079 (1927).

280. *Id.* at 306, 259 P. at 1082.

281. WASH. REV. CODE § 82.45.010 (1989).

282. *E.g.*, *Dabney-Johnston Oil Corp. v. Walden*, 52 P.2d 237 (Cal. 1935) (concluding that an oil and gas leasehold is actually a profit à pendre).

while that same transaction could be exempt from REET if performed by an individual.

### 3. Partnership Transfers Slipped Through the Cracks

An additional inequity in the 1991 Corporate Transfer Act stems from the fact that although the tax attempts to close the REET loophole when realty is transferred through a corporation, the corporate transfer tax does not cover partnership transfers.<sup>283</sup> As discussed earlier, a common method used to transfer real estate and avoid REET is to transfer or assign an interest in a partnership that owns Washington real property.<sup>284</sup> The original version of the 1991 Corporate Transfer Act included taxation of both partnership and corporate transactions.<sup>285</sup> However, partnerships were dropped from the legislation prior to its final passage.<sup>286</sup> As a result, the REET loophole still exists for partnership transfers and will likely cause a shift among taxpayers from the use of corporations to the use of partnerships. Such a shift could easily defeat the purpose of the 1991 Corporate Transfer Act, leaving behind a statute that burdens corporate activities, while failing to close the REET loophole.<sup>287</sup>

### *B. Despite the Legislature's 1991 Efforts, REET Street Is Still in Need of Repair*

Over thirty-five years passed between the time the *Deer Park* court<sup>288</sup> first made changes to the corporate realty transfer aspect of the REET Street blueprint,<sup>289</sup> and the time the legislative REET Street planners set their minds to repairing the court's damage in 1991.<sup>290</sup> The 1991 Corporate Transfer

283. See WASH. REV. CODE ch. 82.45A (Supp. 1990-91).

284. Partnership transfers are discussed *supra* part V.B.

285. See H.B. 1831, 52nd Leg., Reg. Sess. (1991).

286. See WASH. REV. CODE ch. 82.45A (Supp. 1990-91).

287. Similarly, the corporate transfer tax does not include taxation of real estate transferred through a trust. The department could, under its general administrative authority as stated in WASH. REV. CODE ch. 82.32 (1989), attempt to find such transactions taxable through administrative interpretation of existing rules. See WASH. ADMIN. CODE § 458-61-230 (1990) (promulgated for administration of REET). However, such a departmental determination would most likely be construed as an abuse of discretion and not supported by the language of WASH. REV. CODE ch. 82.45A (Supp. 1990-91) (codifying the corporate transfer tax).

288. *Deer Park Pine Industry, Inc. v. Stevens County*, 46 Wash. 2d 852, 286 P.2d 98 (1955).

289. WASH. REV. CODE ch. 82.45 (1989).

290. *Id.* ch. 82.45A (Supp. 1990-91).

Act,<sup>291</sup> as enacted, was intended to tax those corporate transfers of real estate that slipped through the cracks in the REET Street pavement left behind by the court.<sup>292</sup> But it is clear that the 1991 Corporate Transfer Act is riddled with shortcomings<sup>293</sup> that have left some of the REET planners dissatisfied and desiring to make repairs.<sup>294</sup> As a result, the 1992 legislature returned to the drawing board to consider a much greater revision<sup>295</sup> than that occurring in 1991.<sup>296</sup> However, before studying the 1992 proposal in detail, this Comment examines how other states have addressed similar proposals and highlights some tax policy considerations that should be considered.

## VII. GOOD NEIGHBORLY RELATIONS ON REET STREET: EFFORTS BY OTHER STATES AND RELATED TAX POLICY CONSIDERATIONS

Like Washington, New York<sup>297</sup> and Delaware<sup>298</sup> both tax realty transfers. However, those two state's realty transfer taxes differ slightly from Washington's REET,<sup>299</sup> thereby providing two examples of how Washington could rebuild REET Street.

### A. The New York Real Estate Transfer Tax

New York assesses two separate taxes on real estate transactions. Those taxes include a "real estate transfer tax"<sup>300</sup> and a "tax on gains from certain real property transfers."<sup>301</sup> For

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291. *Id.*

292. The corporate transfer loophole, created through judicial interpretation of the REET statutes, is discussed *supra* part IV.

293. A discussion of the shortcomings present in the corporate transfer tax begins *supra* part VI.A.1.

294. See S.H.B. 2447, 52nd Leg., Reg. Sess. (1992).

295. The fiscal note prepared for the 1992 version of S.H.B. 2447 further supports the conclusion that REET and the Corporate Transfer Act combined fail to tax a significant amount of realty sales. See Department of Revenue Fiscal Note no. 92-9 (1992). Because there is no formal disclosure requirement for transfers of real estate interests by corporate or partnership entities, the Department of Revenue has little knowledge of the number of such transactions that actually take place. However, the department's research section estimated that an additional 10.1 million tax dollars could be generated in fiscal year 1993 alone if REET and the corporate transfer tax were replaced with the proposal provided in H.B. 2447 (1992). *Id.*

296. WASH. REV. CODE ch. 82.45A (Supp. 1990-91).

297. N.Y. TAX LAW § 1400 (McKinney 1987).

298. DEL. CODE ANN. tit. 30, § 54-01-5415 (1989).

299. WASH. REV. CODE ch. 82.45 (1989).

300. N.Y. TAX LAW § 1400 (McKinney 1990).

301. *Id.* § 1441.

purposes of analyzing Washington's REET, however, it is necessary only to look at the New York real estate transfer tax.<sup>302</sup>

The New York real estate transfer tax imposes a tax at a rate of two dollars and fifty cents for each five hundred dollars of consideration exchanged for a "conveyance" of real property.<sup>303</sup> Payment of New York's real estate transfer tax, like Washington's REET, is a condition to recording the realty transfer.<sup>304</sup>

For purposes of the New York real estate transfer tax, a "conveyance" is defined as "a transfer or transfers of any interest in real property by any method, including but not limited to sale, . . . conveyance upon liquidation or by a receiver, or a transfer or acquisition of a controlling interest in *any* entity with an interest in real property."<sup>305</sup> Thus, the tax includes transfers of real estate made by corporations and partnerships<sup>306</sup> and is expressly assessed against a conveyance resulting from the liquidation of a corporation.<sup>307</sup> However, the New York real estate transfer tax is only imposed on a conveyance of a "controlling interest" in an entity with an interest in real property.<sup>308</sup> A "controlling interest" is defined as either fifty percent of the voting stock in a corporation, or fifty percent of the interest in a partnership.<sup>309</sup>

Therefore, New York's real estate transfer tax is very similar to Washington's.<sup>310</sup> Like REET, the New York real estate

302. While the New York real property transfer gains tax is triggered by a real estate sale, the gains tax is beyond the focus of this Comment. Because the real property transfer gains tax taxes a seller's income realized from a sale of real property, its underlying theory is inconsistent with Washington's taxing structure that is constitutionally prohibited from imposing a tax on income. See *supra* note 15. The New York real estate transfer tax, on the other hand, is an excise tax similar in nature to REET. Therefore, New York's real estate transfer tax may shed light on how Washington might address its current REET dilemma.

303. N.Y. TAX LAW § 1425 (McKinney 1990).

304. *Id.* § 1410. Once New York's real estate transfer tax is paid, a stamp is affixed upon the recording document. *Id.* While New York's real estate transfer tax can be categorized as a stamp tax, in practice the nature of the tax is the same as an excise tax like REET. See *In re Jacoby-Bender, Inc.* 40 B.R. 10 (Bankr. E.D.N.Y. 1984).

305. N.Y. TAX LAW § 1401(e) (McKinney 1990) (emphasis added).

306. See *id.*

307. *Id.* § 1401(e); Adopted Regulation, 1990 N.Y. Tax LEXIS 523, at \*4 (N.Y. Comm'r Tax & Fin. Oct. 22, 1990) (providing corresponding administrative rule at § [(e)] (5)).

308. N.Y. TAX LAW § 1401(e) (McKinney 1990).

309. *Id.* § 1401(b).

310. WASH. REV. CODE § 82.45 (1989) (REET); *id.* § 82.45A (Supp. 1990-91) (corporate transfer tax).

transfer tax is assessed on a transfer of real property.<sup>311</sup> And like Washington's Corporate Transfer Act, the New York real estate transfer tax is imposed on a transfer of a substantial percentage of voting stock of a corporation that owns real property.<sup>312</sup> Unlike Washington's REET, however, which is imposed on real property "sale,"<sup>313</sup> the New York real estate transfer tax is imposed on a "conveyance" of real property.<sup>314</sup>

The similarities between portions of the New York real estate transfer tax and Washington's newly created Corporate Transfer Act are startling.<sup>315</sup> Significantly, these similarities suggest that the New York tax influenced the drafters of Washington's 1991 Corporate Transfer Act.<sup>316</sup> The New York tax, however, does not include the statutory exceptions that create the earlier discussed deficiencies in the Washington corporate transfer tax.<sup>317</sup> Therefore, the New York tax lends support for retaining Washington's current tax structure, so long as the Washington State Legislature withdraws the current exceptions to the corporate transfer tax that make the tax ineffective.<sup>318</sup>

Although such a proposal is supported by the current use of a similar concept in New York's real estate transfer tax, such an alternative has one disadvantage: The Corporate Transfer Act does not actually tax the real estate transfer *per se*, but instead, taxes a transfer of corporate stock that represents an interest in realty.<sup>319</sup> Because the goal is to tax the actual sale of real estate, it does not make sense to tax the transfer of corporate stock when the actual real estate transfer can be taxed more readily. By taxing the transfer of corporate stock, Washington's new corporate transfer tax unnecessarily

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311. See N.Y. TAX LAW § 1401(e) (McKinney 1990). In such instances, the tax is assessed against the fair market value of the real property transferred, as opposed to a percentage of the consideration actually exchanged for the property. *Cf.* WASH. REV. CODE § 82.45A.010(1) (Supp. 1990-91).

312. N.Y. TAX LAW § 1401(e) (McKinney 1990).

313. WASH. REV. CODE § 82.45.060 (1989).

314. N.Y. TAX LAW § 1401(e) (McKinney 1990).

315. See *id.* § 1401(b) (McKinney 1990); *cf.* WASH. REV. CODE § 82.45A.010(1) (Supp. 1990-91).

316. WASH. REV. CODE ch. 82.45A (Supp. 1990-91).

317. See discussion *supra* part VI.A.1.

318. *Id.*

319. See, e.g., Advisory Op., 1990 N.Y. Tax LEXIS 736, at \*3 (N.Y. Dept. Tax & Fin. Oct. 24, 1990) (analyzing corporate reorganization resulting from the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 requirements).

increases the complexity of corporate transactions.<sup>320</sup> Furthermore, Washington's corporate transfer tax fails to include partnership transfers. Thus, even if Washington's Corporate Transfer Act exceptions are removed from the tax, a crafty real estate transferor who wishes to avoid the tax could still use a partnership as the tax-avoiding transfer vehicle.<sup>321</sup>

The legislature may be better off by simply repealing the recently promulgated Corporate Transfer Act and focusing its energies elsewhere. Delaware provides an alternative approach with greater merits.

### *B. The Delaware Realty Transfer Tax*

Unlike Washington's REET, which emphasizes the transfer of consideration as the taxable event in a real estate sale,<sup>322</sup> Delaware's realty transfer tax imposes a tax upon the "making, execution, delivery, acceptance or presenting" of a document for recording.<sup>323</sup> Payment of the Delaware tax is evidenced by affixing a documentary stamp upon the document that memorializes the realty transfer.<sup>324</sup> The Delaware tax also provides for several exemptions from the Delaware realty transfer tax,<sup>325</sup> as does Washington's REET.<sup>326</sup> However, Delaware's exemptions are excluded from the definition of a taxable "document,"<sup>327</sup> as opposed to Washington's REET, which excludes certain transactions from the definition of a taxable "sale."<sup>328</sup>

Delaware's realty transfer tax includes transfers made through corporations and partnerships.<sup>329</sup> However, Delaware's tax does not tax a conveyance to or from a corporation or partnership where the grantor or grantee had the same proportional interest in the realty before the conveyance,<sup>330</sup> unless the realty transfer results from corporate liquidation or part-

320. *Id.*

321. See discussion *supra* part V.B.

322. See WASH. REV. CODE § 82.45.010 (1989).

323. DEL. CODE ANN. tit. 30, § 5402(a) (1989). The definition of a "document for recording" for purposes of Delaware's realty transfer tax can be found in DEL. CODE ANN. tit. 30, § 5401(1) (1989).

324. *Id.* tit. 30, § 5405.

325. See *id.* § 5401.

326. See WASH. REV. CODE § 82.45.010 (1989).

327. See DEL. CODE ANN. tit. 30, § 5401 (1989).

328. See WASH. REV. CODE § 82.45.010 (1989).

329. DEL. CODE ANN. tit. 30, § 5401(7)a. (1989).

330. *Id.* § 5401(1)n.



nership dissolution.<sup>331</sup>

In Delaware, a realty conveyance made through liquidation or dissolution is taxed if the grantor or grantee has not held the property for at least three years prior to the conveyance,<sup>332</sup> unless the grantor owns eighty percent or more of the beneficial interest in the realty prior to the conveyance and retains eighty percent or more after the liquidation is complete.<sup>333</sup> If the grantor owns less than eighty percent of the beneficial interest in the realty following the conveyance, the conveyance is still taxable only if it is characterized as a sale of real property by Delaware's Secretary of Finance.<sup>334</sup>

Delaware's realty transfer tax statute also requires the Delaware Secretary of Finance to promulgate regulations that assist in determining whether a conveyance resulting from liquidation or dissolution should be characterized as a sale of real property.<sup>335</sup> When promulgating rules, the secretary is required to take into account the "timing of the transaction; beneficial ownership prior to the conveyance or conveyances; the business purpose of the corporation, partnership or trust; and such other factors as may be relevant."<sup>336</sup> If the transaction is found to be a sale of real property, the Delaware realty transfer tax is assessed at a rate of two percent of the "value" of the property.<sup>337</sup> The "full and complete value" of the property must be set forth in any document presented for recording in Delaware, and it must be accompanied by an affidavit stating that the value presented in the document is legitimate.<sup>338</sup>

As a result, Delaware's realty transfer tax statute gives a clear definition of the corporate and partnership realty transfers that Delaware's legislature intends to tax. The statute also gives Delaware's Secretary of Finance the discretion to promulgate rules to address future realty transactions that might have been inadequately addressed by the legislature.<sup>339</sup> Compared to Washington's REET, the Delaware realty transfer tax is less open to judicial interpretation and is more easily

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331. *Id.*

332. *Id.*

333. DEL. CODE ANN. tit. 30, § 5401(7)c. (1989).

334. *Id.*

335. *Id.*

336. *Id.*

337. *Id.* § 5402.

338. DEL. CODE ANN. tit. 30, § 5409 (1989).

339. *Id.* § 5407.

tuned by administrative rule. And finally, unlike Washington's REET, the Delaware realty transfer tax is not plagued by the ambiguous nature of determining whether a transaction has been made in exchange for consideration.

Now that we have considered how New York and Delaware tax real estate transfers, we are ready to consider what the 1992 Washington legislative proposal to remodel REET Street entailed. Although the 1992 legislation never made it out of committee, the legislation proves that the legislature is studying REET. It is likely that the legislature will return REET Street to the docket in 1993. Therefore, looking at the failed 1992 proposal provides insight into the initial direction and future direction of the legislature.

#### VIII. WASHINGTON'S 1992 PROPOSAL: WHAT WAS AT STAKE?

During the 1992 Legislature, Governor Booth Gardner requested consideration of House Bill (HB) 2447.<sup>340</sup> The bill was subsequently amended by the House Committee on Revenue<sup>341</sup> and redrafted as Substitute House Bill (SHB) 2447.<sup>342</sup>

SHB 2447 was aimed at rewriting Washington's currently existing real estate sales tax laws by replacing them with a "conveyance" tax on real property transfers.<sup>343</sup> The tax rate for the conveyance tax was to remain the same as the current REET rate: 1.28 percent plus local options.<sup>344</sup> By restructuring the tax to close the existing loophole created by *Deer Park* and its progeny, an additional \$11.5 million in revenue per fiscal year was anticipated.<sup>345</sup>

More specifically, SHB 2447 would have replaced the current use of the term "sale" as the taxable event in RCW 82.45.010 with the term "conveyance."<sup>346</sup> The bill also would

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340. H.B. 2447, 52nd Leg., Reg. Sess. (1992).

341. The substitute bill clarified that the existing local REET options and associated revenues would not be effected by the legislation. It further clarified that property tax liens would take priority over REET liens; that entering into an earnest money agreements would not be characterized as taxable transactions; and that creation of lien, by means of a mortgage, would not be taxable. H.B. Rep., H.B. 2447, 52nd Leg., Reg. Sess. (1992).

342. S.H.B. 2447, 52nd Leg., Reg. Sess. (1992).

343. *Id.*

344. *Id.*

345. Fiscal Note, S.H.B. 2447, 52nd Leg., Reg. Sess. (1992). This estimate was based on an actual survey of REET affidavits that were exempt under the current law. *Id.*

346. S.H.B. 2447, 52nd Leg., Reg. Sess. (1992).

have abolished all currently exempt transactions from the definition of "sale."<sup>347</sup> In exchange, the bill would have only excluded the transfer of an easement, leasehold, license, equitable servitude, purchase option, and earnest money agreement from the definition of a taxable conveyance.<sup>348</sup>

Additionally, SHB 2447 would have replaced the current REET definition of "selling price," which is defined as the consideration exchanged for the real property transfer,<sup>349</sup> with the term "taxable value," which is defined in SHB 2447 as "the true and fair value of the property conveyed."<sup>350</sup> As a result, SHB 2447 would have calculated the amount of tax owing as a percentage of the "true and fair market value of the property conveyed," as opposed to the current method of using a percentage of the consideration exchanged in the realty transfer. The true and fair market value is then defined as the total consideration exchanged in an arm's length transaction, or under other circumstances, the assessment value of the property as maintained on the county property tax rolls.<sup>351</sup> Thus, by tying the taxable value to the property tax roles, the bill goes into significant detail as to how the county assessors are to calculate the property value, especially in the case of standing timber.<sup>352</sup>

Although the bill would have abolished the currently existing exemptions from REET's definition of a taxable sale, it would have also recreated several exemptions in a section specifically listing tax exempt realty transactions.<sup>353</sup> While a complete discussion of the differences between the prior REET exemptions and the SHB 2447 exemptions is beyond the scope of this Comment, one difference is worth noting. SHB 2447 would have limited the existing exemption for gift transfers solely to gifts made to a family member or an entity exempt from federal income tax under Section 501(c) of the Internal Revenue Code.<sup>354</sup>

Now that we have briefly overviewed SHB 2447, we can look at how the legislature proposed to solve the loophole cre-

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347. See discussion on exemptions *supra* part III.A.

348. S.H.B. 2447, 52nd Leg., Reg. Sess. § 1(3), (4) (1992); cf. WASH. REV. CODE § 82.45.010 (1989).

349. WASH. REV. CODE § 82.45.030 (1989).

350. S.H.B. 2447, 52nd Leg., Reg. Sess. § 3 (1992).

351. *Id.*

352. *Id.* §§ 18, 20, 21, 22.

353. *Id.* § 6.

354. *Id.* § 6(1). See I.R.C. § 501(c) (1988).

ated by *Deer Park* and its progeny. The plan was quite simple: it would have taxed any conveyance made by a nonfamily-held corporation,<sup>355</sup> with the exception of a transfer pursuant to court approved reorganization under Chapter 11 or 12 of the Bankruptcy Code.<sup>356</sup>

As a result, SHB 2447 represented the most comprehensive taxing proposal we have seen regarding taxing realty transfers by corporations. Because the proposal was to replace the current REET prerequisites of a "sale"<sup>357</sup> for "consideration"<sup>358</sup> with the concept of a "conveyance,"<sup>359</sup> the proposal would have closed the *Deer Park* loophole and was therefore more comprehensive than REET. Also, because the proposal contained none of the exemptions in Washington's current Corporate Transfer Act,<sup>360</sup> the proposal was much more restrictive. And finally, because the bill did not take into account the percentage of realty ownership that was actually transferred to a new party in the conveyance, the proposal was more inclusive than either the New York or the Delaware taxes discussed above. SHB 2447 failed,<sup>361</sup> however, leaving open the question of whether the proposal was too comprehensive and inflexible for corporations performing legitimate corporate planning activities.

## IX. THE FUTURE OF REET

As the legislature's 1992 consideration of SHB 2447 makes clear, REET's development is incomplete. The question we must now consider is where should the legislature go from here? The answer lies in one of several viable alternatives. The appropriate alternative should be guided by a consideration of how much flexibility corporations and partnerships should have to practice legitimate business reorganizing functions. It is important to recognize, however, that allowing too much flexibility creates a risk that the tax can easily be avoided. An optimal balance would capture all realty transac-

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355. See S.H.B. 2447, 52nd Leg., Reg. Sess. § 6(5) (1992).

356. *Id.* § 6(15). See 11 U.S.C. §§ 1101-1231 (1988 & Supp. II 1990).

357. WASH. REV. CODE § 82.45.010 (1989).

358. See *id.* § 82.45.030.

359. S.H.B. 2447 Sec. 1, 52nd Leg., Reg. Sess. (1992).

360. WASH. REV. CODE § 82.45A.030 (Supp. 1990-91).

361. S.H.B. 2447 was passed to the House Rules Committee by the House Revenue Committee; however, the bill was never pulled from the Rules Committee and, thus, died without floor debate. WASHINGTON STATE LEGISLATURE HISTORY REPORT, S.H.B. 2447, 52nd Leg., Reg. Sess. (1992).

tions where a significant ownership percentage actually changes hands, while not affecting transfers by corporations and partnerships when the same individual continues to own the realty before and after the transfer.

At one end of the spectrum, we have the 1991 Corporate Transfer Act, which provides several exceptions to allow flexibility. However, the exceptions also allow the tax to be avoided easily. At the other end of the spectrum, we have SHB 2447, which provides no flexibility for corporations or partnerships, while leaving no doubt when the transfer will be taxed. The solution is to find an acceptable middle ground.

The legislature could solve the REET Street dilemma within the confines of the existing REET statute.<sup>362</sup> Currently, REET allows a real estate transfer to a corporation or partnership that is wholly owned by the transferor, or the transferor's spouse or children, without invoking the tax.<sup>363</sup> REET becomes due on the original transaction, however, if the transferee corporation or partnership transfers the realty to someone other than the transferor or his spouse or children within five years after the original transaction.<sup>364</sup> Thus, the statute, as it now stands, can provide flexibility for close family transactions. However, when those transactions lead to a transaction that is beyond the scope the legislature intended to give preferential treatment to, the statute recaptures the tax that should have been paid on the original transaction.

There is, therefore, no reason why the legislature could not expand the existing recapture provision to include all corporate and partnership transactions. By doing so, the legislature would provide flexibility to realty owners who want to perform legitimate business planning functions by holding realty in different forms. However, if the realty is actually transferred to a new owner within a set period of time, any tax due on the original transaction could be recaptured. From a tax administration standpoint, the proposal is not overly burdensome. When the taxpayer executes the original transfer, the county treasurers could simply enter the transaction into a database; if a subsequent taxable sale takes place, the treasurer could flag the original transfer for purposes of recapturing the tax. But while this solution could be created with minimal

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362. WASH. REV. CODE ch. 82.45 (1989).

363. See *id.* § 82.45.010 (1989).

364. *Id.*

alteration of the current REET statute, it would only increase the already confusing nature of Washington's REET and force taxpayers to keep track of potential recapture liability.

So it seems that the answer lies not in trying to amend Washington's already existing REET statute, but instead, in rewriting the law to accomplish three goals: (1) make the new law more clear regarding tax liability; (2) close the partnership and corporate transfer loophole; and (3) allow a reasonable amount of flexibility for corporations<sup>365</sup> and partnerships<sup>366</sup> to reorganize. As discussed earlier in this Comment,<sup>367</sup> because Washington's REET is based on a "sale" for "consideration," many questions have arisen regarding whether to tax a given transaction.<sup>368</sup> Although most of those questions have been answered, finding answers to unlock the questions of future transactions is unduly difficult and burdensome,<sup>369</sup> especially to the unwary taxpayer who is new to this area of the law. Thus, it is time to say goodbye to today's REET.

As a replacement, the 1992 legislative proposal, SHB 2447, has a great deal of merit if one change is made. Looking back to our three goals, SHB 2447 accomplishes two of them in its present form: (1) the proposal makes the law clearer regarding tax liability;<sup>370</sup> and (2) the proposal would close the part-

365. *E.g.*, Advisory Op., 1989 N.Y. Tax LEXIS 514, at \*2 (N.Y. Comm'r Tax & Fin. Dec. 8, 1989) (finding realty transfer from subsidiary to parent corporation in exchange for no consideration and without any change in beneficial ownership of the property is not a taxable transaction).

366. *E.g.*, *Oceanside Harbor Associates v. Director of Revenue*, 565 A.2d 893 (Del. 1989) (finding three individuals transferring realty into newly created partnership while maintaining same aggregate percentage of realty ownership before and after transfer is not a taxable transaction); *see also* *Three Hundred Delaware Ave. Associates v. City of Wilmington*, 294 A.2d 105 (Del. 1972) (allowing "round trip" safe harbor for straw conveyance from partnership A to Straw Corporation to partnership B when real property ownership remained the same at all times).

367. *See* discussion *supra* part III.

368. *E.g.*, JOHN J. O'CONNELL, *OPINIONS OF THE ATTORNEY GENERAL ON EXCISE TAX ON REAL ESTATE SALES* (1968) (compiling several Attorney General opinions that were requested due to confusion surrounding the sale for consideration requirement).

369. Washington's REET is not alone in creating confusion and court action aimed solely at defining the term "consideration" in the realty transfer tax context. *See, e.g.*, *In re Park Ten Associates v. New York Dep't of Finance*, 526 N.Y.S. 2d 962 (N.Y. 1988) (considering effect of mortgage on total amount of consideration exchanged). Confusion will always exist because "consideration" is a legal term of art and, as such, it is subject to differing interpretations when used to calculate the total value of a realty exchange. *See generally* E. ALLAN FARNSWORTH, *CONTRACTS* § 211 (2d ed. 1990).

370. By replacing REET's current prerequisite of a sale for consideration with the concept of a taxable "conveyance," a taxpayer's liability is clarified. While questions can arise whether consideration has actually been exchanged in a real estate

nership and corporate transfer loophole. But in order to accomplish the third goal of allowing corporations and partnerships a reasonable amount of flexibility, SHB 2447 needs amending. The language for that amendment can be found in the analogous Delaware statute.<sup>371</sup>

Delaware's realty transfer tax, like SHB 2447, taxes a real estate conveyance as opposed to a real estate sale. However, unlike SHB 2447, Delaware's tax contains two exemptions that are specifically aimed at allowing corporations and partnerships flexibility in holding real estate.<sup>372</sup> Those exemptions carry out the same goals as the 1991 Washington Corporate Transfer Act, but they are not plagued by the exceptions that make the Corporate Transfer Act ineffective.

Thus, by incorporating the Delaware exemptions into the

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transaction, there is little doubt that a conveyance has taken place when a grantee produces title to newly acquired realty, requesting that it be recorded under a new name.

371. DEL. CODE ANN. tit. 30, §§ 5401(1)(n), 5401(7)(a), 5401(7)(c) (1989). More specifically, the applicable language states:

(1) "Document" . . . shall not include the following:

n. Any conveyance to or from a corporation, or a partnership, where the grantor or grantee owns stock of the corporation or an interest in the partnership in the same proportion as his interest in, or ownership of, the real estate being conveyed; provided, however, that this paragraph shall not apply to any distribution in liquidation or other conveyance resulting from partial or complete liquidation of a corporation, unless the stock of the corporation being liquidated has been held by the grantor or grantee for more than 3 years; provided, further, this paragraph shall not apply to any conveyance from a partnership to its partners unless the partners' interest in the partnership has been held for more than 3 years. . . .

(7) a. Except as provided in paragraph . . . c. of this subdivision, where beneficial ownership in real estate is transferred through a conveyance or series of conveyances of intangible interests in a corporation, partnership, or trust, such conveyance shall be taxable under this chapter . . . .

c. Where the beneficial owners of real property prior to the conveyance or series of conveyances referred to in this subdivision own 80% or more of the beneficial interest in the real estate following said conveyance or conveyances, such transfers shall not be subject to tax under this subdivision. Where the beneficial owners of real property prior to the conveyance or series of conveyances referred to in this subdivision own less than 80% of the beneficial interest in the real estate following said conveyance or conveyances, such transfers shall not be subject to tax under this subdivision, unless, under regulations promulgated by the Secretary of Finance, such transfer or transfers are properly characterized as a sale of real property. Such characterization shall take into account the timing of the transaction, beneficial ownership prior to and subsequent to the conveyance or conveyances; the business purpose of the corporation, partnership, or trust; and such other factors as may be relevant. *Id.*

372. *Id.*

language of SHB 2447, the Washington State Legislature could accomplish all three goals. The final result would allow a grantor, corporation, or partnership to transfer realty into separate forms without incurring real estate sales tax liability, unless a specific percentage of the real estate transferred actually changes hands. The proposal could also vest sufficient authority in the Department of Revenue to promulgate rules that would address additional tax liability issues as they occur. And finally, the legislature could abolish both REET and the Corporate Transfer Act, leaving one consistent realty transfer tax in their place.

#### X. THE END

While REET has served Washington well over its several decades of existence, it has always contained the inherently difficult concept of when the tax is triggered, which is not by the transaction, but by whether consideration is exchanged. Unnecessary confusion and uncertainty confronting real estate transaction planners has resulted. Even the Washington State Supreme Court interpreted its way out of several opportunities to clear up the confusion,<sup>373</sup> each time coming to a reasonable interpretation regarding whether consideration was actually exchanged in the transaction before the court. But, in the aggregate, those interpretations show that REET can easily be manipulated by corporate and partnership realty transfers. Thus, REET must be entirely redeveloped. A new tax statute should be created that is facially clear.

In sum, this story of REET Street sought to accomplish two goals: (1) to give the reader a complete understanding of what REET means today; and (2) to advocate a legislative revision of REET for tomorrow. Hopefully, this story will become only a historical perspective of REET Street once the Washington State Legislature finally solves the *Deer Park* puzzle.

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373. See *Estep v. King County*, 66 Wash. 2d 76, 401 P.2d 332 (1965); *Doric Co. v. King County*, 57 Wash. 2d 640, 358 P.2d 972 (1961); *Deer Park Pine Industry, Inc. v. Stevens County*, 46 Wash. 2d 852, 286 P.2d 98 (1955).