Cite as Det. No. 16-0111, 36 WTD 103 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 16-0111
. . .	)	Registration No. . . .

RCW 82.45.010; RCW 82.45.060; WAC 458-61A-101; WAC 458-61A-106: LEASEHOLD IMPROVEMENTS – CLASSIFICATION OF PROPERTY. The sale of a controlling interest in an entity that owned leasehold improvements was subject to real estate excise tax, notwithstanding that county assessors classified the leasehold improvements as personal property on the county property tax rolls.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Valentine, A.L.J. – A taxpayer protests the assessment, by the Washington Department of Revenue (Department), of Real Estate Excise Tax (REET) on the transfer of a controlling interest in a Washington corporation. The taxpayer contends the corporation did not own real property in Washington at the time of the transfer. Taxpayer's petition is denied. [1]

ISSUE

Pursuant to RCW 82.45.060, RCW 82.45.010, WAC 458-61A-101 (Rule 61A-101), and WAC 458-61A-106 (Rule 61A-106), if there is a controlling interest stock transfer in a Washington corporation, is the controlling interest transfer a sale subject to Washington REET when, at the time of the transfer, the corporation owned only property that was taxed as personal property for property tax purposes?

FINDINGS OF FACT

[Taxpayer] operated 28 supermarkets in Washington at the time of the stock transfer at issue. Taxpayer did not own the land and buildings at the time of the transfer. Rather, Taxpayer leased its supermarket stores (land and buildings) from a combination of related and unrelated, third-party entities. Taxpayer owned and paid personal property tax on the personal property listed on the tax rolls of the Washington counties in which it had stores. The Washington counties in which Taxpayer's stores were located carried only personal property owned by Taxpayer on the county

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

tax rolls. None of the leases required that Taxpayer remove leasehold improvements[2] at the end of the lease.[3]

On March 10, 2011, Taxpayer sold 100 percent of its stock to [LLC] pursuant to a stock purchase agreement, dated January 31, 2011. Section 2.9(a) of the stock purchase agreement reads, in pertinent part: "Neither the Company nor any of its Subsidiaries owns any real property or interest (other than leasehold interest) in real property." Although Taxpayer transferred more than 50 percent of its stock, Taxpayer did not complete and file a REET affidavit at the time of the transfer because its belief was that it did not own real property in Washington.[4]

The Department's Special Programs Division (Special Programs) reviewed the stock transfer and determined that REET was due on the value of Taxpayer's property classified as Leasehold Improvements listed on the county tax rolls.[5] Special Programs contends that Leasehold Improvements are real property, the sales of which are subject to REET.

Taxpayer asserts that the Leasehold Improvements at issue are personal property and, thus, not subject to REET. The various county tax rolls listed Leasehold Improvements separately from items of personal property such as furniture and computer equipment. Taxpayer did not provide a detailed description of what exactly constituted the Leasehold Improvements listed on the county tax rolls. Rather, it is Taxpayer's position that REET is not due on the value of the Leasehold Improvements because the Leasehold Improvements are carried on the county tax rolls as personal property.

ANALYSIS

RCW 82.45.060 imposes an excise tax "upon each sale of *real property*." (Emphasis added.) *See also* WAC 458-61A-100. RCW 82.45.010(1) defines the term "sale," for real estate transactions, as "any conveyance, grant, assignment, quitclaim, or transfer of ownership or title to *real property* . . . for a valuable consideration." (Emphasis added.) In addition, the term sale also includes "the grant, assignment, quitclaim . . . or transfer of *improvements constructed upon leased land*." *Id.* (Emphasis added.) RCW 82.45.080 imposes the REET obligation on the seller.

RCW 82.45.032 defines the terms "real estate" and "real property" as "any interest . . . in land or anything affixed to land, [. . . . The term includes . . .] improvements constructed upon leased

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[2] "Leasehold improvements (or tenant improvements) are items put in place specifically for use by a tenant. They differ physically from trade/domestic fixtures in that they are constructed on site rather than merely installed (or modified and installed). Examples include the build-out of a reception area or an office space with partitions, cabinets and countertops." http://www.appraisalinstitute.org/assets/1/7/guide-note-5.pdf (Appraisal Institute website last visited on March 21, 2016.)

[3] Special Programs reviewed the leases. Although most of the leases allowed Taxpayer to remove the leasehold improvements and/or allowed the lessors to require the removal, none of the leases expressly required removal by the lessee.

[4] RCW 82.45.010(2)(a) explains that "[t]he term 'sale' also includes the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration." There is no dispute in this case that a controlling interest transfer for valuable consideration occurred.

[5] Special Programs reviewed the tax rolls of the counties in which Taxpayer leased the land and buildings. Special Programs totaled the amounts listed as Leasehold Improvements and based the REET assessment on that amount. There is no dispute that Taxpayer owned the property classified as leasehold improvements.

land." RCW 84.04.090 defines the term "real property" as follows: "The term 'real property' for the purposes of taxation shall be held and construed to mean and include the land itself . . . *and all buildings, structures or improvements or other fixtures of whatsoever kind thereon* . . ." (Emphasis added.) Rule 61A-102(16) adds the following definition: "[Real estate] or [real property] means any interest . . . in land or *anything affixed to land* . . . ." (Emphasis added.) Thus, the term "improvement" can mean something other than a shell building or structure. RCW 82.45.032; RCW 84.04.090.

Rule 61A-106(1)(b) states that "[t]he transfer of a lessee's interest in a leasehold for valuable consideration is taxable to the extent the transfer includes any improvement constructed on leased land." Rule 61A-106(1)(a) explains that "[t]he sale of improvements constructed on real property is subject to the real estate excise tax if the contract of sale does not require that the improvements be removed at the time of the sale." If the sales contract requires that the improvements be removed from the land as part of the sale, REET does not apply to the sale of the improvements. Rule 61A-106(3). In this case, none of the leases require that the lessee remove the leasehold improvements at the termination of the lease.

RCW 82.45.030(4) explains that the assessed value of the property sold will be used as the sale price of the property if "the total consideration for the sale cannot be ascertained or the true and fair market value of the property to be valued at the time of sale cannot be reasonably determined." *See also* Rule 61A-106(1)(b). Rule 61A-101(4) states that the "selling" price means "the true and fair value of the . . . property . . . at the time the controlling interest is transferred." A fair market appraisal[6] of the property or an allocation of assets made pursuant to section 1060 of the Internal Revenue Code[7] are two methods that may be used for determining true and fair value. Rule 61A-101(4)(a)(i) and (ii). If the true and fair market value of the property at issue cannot be reasonably determined by either of the aforementioned methods, "the market value assessment for the property maintained on the county property tax rolls at the time of the sale will be used as the selling price." Rule 61A-101(4)(b).

The Department addressed the issue of whether leasehold improvements are subject to REET in Det. No. 00-122, 20 WTD 461 (2000): "[U]nder the REET statutes, REET applies to the transfer of leasehold improvements when the lessee owns the improvements . . . ." [RCW 82.45.032(1).] Also in 20 WTD 461, the Department stated the following: "We believe the statutes and rules relating to the real estate excise tax (REET) provide a more appropriate basis for classifying the assets purchased. The issue is what tax was appropriate for the sale, not what tax is appropriate for property tax assessment purposes." Thus, the Department's position is that the classification of leasehold improvements for property tax purposes is not determinative as to whether the property is subject to REET when sold.

[6] Taxpayer did not submit an appraisal of the property at issue.

[7] Taxpayer submitted a copy of its Form 8594 (Asset Acquisition Statement Under Section 1060), but the form does not include a breakdown of the fair market value of the Class V property (tangible property and other assets). Thus, it is impossible to determine the value of the leasehold improvements from Form 8594. We also note that the aggregate fair market value of the Class V assets differs from the allocated sales price.

Taxpayer contends that the Department's position is the opposite based on Det. No. 00-121, 21 WTD 281(2002). Specifically, Taxpayer points to this language in the determination:

> The parties, apparently, agree that the price paid for the stock does not reflect the true and fair value of the real property. The Department has used alternative means to compute true and fair value. The taxpayer has not suggested that the price paid for the stock equates to the true and fair value of the [Subsidiary] real property. Neither has the taxpayer proposed any other method for determining the measure of REET, such as a "fair market appraisal" or an "allocation of assets" pursuant to section 1060 of the Internal Revenue Code.
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> Rather than availing itself of the opportunity to measure the tax by an alternative means of establishing the true and fair value, i.e. an appraisal, the taxpayer has challenged the county assessor's valuation of the property. The assessor's valuation, necessarily, contains a characterization of property as real or personal. The assessor's valuation is its valuation, and we will not disturb the assessor's valuation by adjustments to that characterization.

Thus, Taxpayer argues that since the county assessors in the present case classified the leasehold improvements as personal property for property tax purposes, there is no REET due for the sale of real property.

21 WTD 281, however, can be distinguished from the case at issue. The language in 21 WTD 281 highlighted by Taxpayer applies to the *valuation* of the property. The determination clearly states that "we will not disturb the assessor's *valuation* by adjustments to that characterization." (Emphasis added.) In addition, in the beginning of the second cited paragraph above, the Department states that the taxpayer "challenged the county assessor's valuation of the property" and did not "[avail] itself of the opportunity to measure the tax by an alternative means of establishing the true and fair value, i.e. an appraisal."

In the present case, Taxpayer objects to the REET assessment because the county assessors carried the leasehold improvements on the personal property tax rolls. Taxpayer does not object to the actual valuation of the leasehold improvements *per se*. We also note that we did not find, nor did Taxpayer offer, citations to any Washington statutes or controlling case law that states REET, a transaction or excise tax, will not be due on the sale of leasehold improvements simply because the leasehold improvements are carried on the personal property tax rolls. In addition, the county assessors listed the leasehold improvements on the tax rolls separately from other property that was clearly personal property, such as furniture, computer equipment, and other machinery and equipment. Thus, even the county assessors distinguished the leasehold improvements from other types of personal property.

In summary, the controlling interest transfer at issue included the sale of leasehold improvements. Taxpayer owned the leasehold improvements at the time of the transfer. None of the leases required that the leasehold improvements be removed at termination of the leases. REET is due on the value of the leasehold improvements. Special Programs was authorized to use the assessor's valuation of the property. Taxpayer's petition is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 23rd day of March 2016.