LUKINS&ANNIS | ATTORNEYS

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## REAL ESTATE AND ESTATE PLANNING

## I. REAL ESTATE EMOTIONAL ASSET

### A. UNIQUE BUSINESS ASSET

1. Farm Property
2. Manufacturing Plant
3. Restaurant Location
4. Hotel
5. Mini Storage
6. Assisted Living and Senior Housing
7. A superior Lease Location
8. Mineral Rights
9. Water Rights
10. Royalty Interest

### B. COVETED INVESTMENT ASSETS

1. Shopping Centers
2. Apartments
3. Office Building - professionals such as doctors and dentists own their own buildings

### C. FAMILY VACATION HOMES ("FVH") – typically the most cherished of all family assets

1. Family Gatherings, Memories
   - (a) Grandpa & Grandma
   - (b) Siblings
   - (c) Parents
2. Lots of Fun – Vacations Spent There
3. Family Traditions
   - (a) Fourth of July
   - (b) Barbeques
4. Family Work Parties
   - (a) Do one thing each day to make our place better
   - (b) Some have significant sweat equity

5. Family Games
6. Encounter and Resolve Family Problems
7. Bird Watching, Animal Observations
8. Sunsets
9. Cocktail Hours
10. Skinny Dipping
11. Bon Fires - Smores & Marshmallows

**II. <u>IN DOING ESTATE PLANNING FOR REAL PROPERTY ASSETS</u>** - need to consider the following:

**A. STATES OR FOREIGN COUNTRIES WHERE LOCATED**

1. Estate tax issues (State Law - Controls) see <u>Comr. V Bosch Est 387 US 456 (1967)</u>

(a) Property purchased with Out of State funds – usually separate property. The "source doctrine" will be applied to real property purchased in Washington with funds derived from the sale of an asset in another state.

(b) Quasi-Community Property – RCW 26.16.220-250

(c) Community Property brought from another state retains character

(d) Real Property located in another state owned by Washington resident not likely community property but tenants in common

(e) Valid Marriage

(f) Domestic Partnerships – RCW 26.60

(g) Joint Tenancy to A & B with right of survivorship and not to tenant's in common – RCW 64.28.010

(h) Right to Partition – right to sever his or her interest

(i) The relative shares of each tenant – IRC 2040

(j) Whether it can be revoked by person who created it, or by either person

(k) The proper disposition of the property in case of simultaneous death

(l) Right of creditors Commissioner v <u>Dasik</u> Estate 387 US 45b (1967) - in most jurisdictions jointly held property is subject to the claims of a creditor of the one who created the joint interest

2. Excise tax issues – varies by county

(a) WAC 458-61A-201 – RCW 82.45 imposes an excise tax on every sale of real estate in the state

(b) If there is a sale of controlling interest in entity, excise tax is due WAC 458-61A-101

(i) Controlling Interest –

a. Corporations - 50% or more if total combined voting power of all classes of stock of the corporation entitled to vote, or beneficial interest in the voting stock of the corporation

b. LLCs or Partnership – 50% or more of the capital, profits or beneficial interest in such partnership, association, trust, or other entity

(ii) In order for tax to apply when the controlling interest in an entity that owns real property is transferred the following must have occurred

a. The transfer or acquisition of the controlling interest occurred within 12 month period

b. The controlling interest was transferred in a single transaction or series of transactions by a single person or acquired by a single person or a group of persons acting in concert

c. Entity has an interest in real property located in this state

d. Transfer not otherwise exempt (see WAC 458-61A-211 – mere change in identity WAC 458-61A-212 non-recognition for entity formation liquidation, dissolution, and reorganization

e. The transfer made for valuable consideration

(iii) Tax is full amount of the value of the property – "Selling Price" means the true and fair value of the real property owned by the entity at the time the controlling interest is transferred – WAC 458-61A-101(4)

(c) Transfers by gift may still be subject to Real Estate Excise Tax – WAC 458-61A-103

(i) Recourse - Transfers involving underlying debt: the Real Estate Excise Tax applies to transfers of real property when the grantee relieves the grantor from an underlying debt on the property or makes payments on the grantor's debt

(ii) Measure of Tax: the combined amount of the underlying debt on the property and other consideration

(iii) Nonrecourse Debt: Real Estate Excise tax does not apply when grantor has no personal liability for the debt

(iv) Gift otherwise exempt: WAC-458-61A-201

(d) Exchanges subject to Excise Tax - siblings trading properties

(e) Transfers where gain is not recognized under the Internal Revenue Code – WAC 458-61A-212 – no tax due

(i) 332 corporate liquidations

(ii) 351 corporate organization

(iii) 368 reorganization

(iv) 721 to LLCs or partnerships

(v) 731 distribution to partners

(f) Tenants in common and joint tenants WAC 458-61A-204 - excise tax does not apply to the transfer of real property that results in the creation of a tenancy in common or joint tenancy with or without right of survivorship

(g) Inheritance or Devise – WAC 458-61A-202 (generally no tax)

(i) Non prorata distribution incurs no tax as long as transfer is authorized under the non-intervention powers of a personal representative under RCW 11.68.090 or under the non-prorata distribution powers of a transfer under RCW 11.98.070(15)

(ii) Transfers by Community Property Agreement: no tax

(iii) Joint tenants: transfer to survivor under JTWROS – no tax

(iv) Life estates: remainder interest – conveyance of a life estate to the grantor with a remainder interest to another party is not a taxable transfer if no consideration passes

3. Creating an entity: for an Idaho FVH or other real estate - if you create an Idaho or Washington LLC for a Washington resident - now creating a tax in the state of Washington since owning an LLC is personal property Washington estate tax only applies to a decedent's real and tangible personal property located in Washington and to intangible personal property of Washington "residents" that is, decedents who were domiciled in Washington at the time of death. May be real property and tangible personal property located outside Washington should be removed from LLCs, partnerships and corporations and placed in revocable or irrevocable trusts.

4. Inheritance Tax - State apportionment tax issues: Washington and other states apportion their inheritance tax based upon a percentage of assets inside the particular state over the total gross estate (see Washington Estate and Tax Return).

5. Issue of domicile: voter registration, mailing, address, driver's license. In Washington all intangibles allocated to the state of domicile (see David Green email).

**B. TITLE ISSUES**

1. Who owns – vested owner (probably should obtain title review)

2. Options

3. Rights of First Refusals (ROFR)

4. Joint tenants with rights of survivorship

5. Life estates

6. Leases obligations

## C. TITLE INSURANCE ISSUES - EXAMPLE

Presume a married couple acquired an apartment building in 2006 for $1,000,000. They received a title insurance policy in that amount. In 2008 for estate planning and business succession reasons, they formed a family LLC where they and their five children were the only members. They quit claim the title to that property to their LLC. Soon thereafter, a Notice of Trustee Sale was received to foreclose a Deed of Trust created by prior owners in 2003 claiming a $300,000 remaining balance. The title insurance company that insured the purchase in 2006 did not show that encumbrance as an exception due to a forged reconveyance. However, that title company denied coverage to protect against that $300,000 loss, based on the termination of that policy by the transfer to the LLC.

In the example, does the prior title policy continue to protect against the loss suffered by the purchases after their deed to the LLC? Is there some other type of claim against the title company for its negligence? What could the estate planning attorney have done differently to protect these clients?

1. Deeds to create a living trust or to create a family LLC will not give direct rights to successor. Successors are those who succeed to the interest of the named insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives.

See:

(a) Covalt v First American Title Insurance Co. 105F. 3rd 669, 1997 WL4273 (10th Cir. Jan. 7, 1992) ruling that transfer of real property, by quit claim deed, from individual to trust in which individual retained an interest, prevented trust from claiming any rights under title policy.

(b) Fairway Development Co. v Title Insurance Co. of Minnesota – 621 F. Supp 120 (N.D. OH. Aug 26, 1903

(c) Butler v Attorney Title Guaranty Fund Inc. 321 IL. App. 3d 601, 747 NE 2nd 949 (2001) holding that a deed from a trust to corporation, where shareholders were the sole beneficiary of the trust, was a transfer by purchase and not a transfer by operation of law that would provide continuing coverage under the owner's title policy

2. Don't want to litigate with a title company – need to either purchase an endorsement to the prior policy, or obtain a new policy.

3. Example of an endorsement specifically extended to the successor LLC.

"Notwithstanding the definition of "Insured" contained in paragraph 1 of the Conditions and Stipulations of the Policy, liability of the Company to the

original named Insured under the Policy shall not be denied to a successor Limited Liability Company (LLC) grantee of the original named Insured under a deed conveying the land, as long as: (1) the LLC is wholly-owned by the same persons or entities that held beneficial ownership of the land as the original named Insured, and (2) such conveyance is without valuable consideration passing to the persons or entities that held beneficial ownership of the land as the original named Insured."

All the endorsement forms in use limit their scope to the addition of the additional named Insured, without providing any coverage for matters that occurred since the original policy date.

4. Limitation of prior policy date, policy amount defenses of coverage, conditions contained in prior forms co-insurance limitations

5. Consider Statutory Warranty Deed rather than Quit Claim Deed, Bargain & Sale Deed or Special Warranty Deed

6. Other insurance issues – liability policies, casualty policies, umbrella policies – family entities should be specifically covered.

**D. BUY-OUT AGREEMENTS** - option or obligations to purchase or sell

1. Funded or unfunded (Life Insurance)

2. Professional practices – often they do have buyout provision for new doctors or dentists, or alternatively for returning doctors or dentists

3. IRC Section 2703 – Buy-Sell Agreement disregarded for tax purposes unless it meets three tests – Chapter 14

(a) Bona-fide arrangement

(b) Must not be a devise to transfer property to family members

(c) Agreement "comparable" to similar arrangements entered into by persons in an arms-length transaction

**E. DEBT ISSUES - RECOURSE DEBT**

1. Due on sale provision – when transfers to another entity is there a right to accelerate the debt and demand payment

2. On death of guarantor – often an event of default

3. Who is going to succeed to liability

4. "Bad Boy Carve Out" – convert nonrecourse or recourse debt

**F. REAL PROPERTY CONTAINING HAZARDOUS SUBSTANCES OR TOXIC WASTE**

1. Review leases, Phase I Report – not mandatory under the Comprehensive Environmental Response Consent

2. Ownership structure

3. RCW 64.06 requires a seller to provide seller statement form. This chapter does not apply to the following transfers of real property:

(a) A foreclosure or deed-in-lieu of foreclosure;

(b) A gift or other transfer to a parent, spouse, domestic partner, or child or a transferor or child of any parent, spouse, or domestic partner of a transferor;

(c) A transfer between spouses or between domestic partners in connection with a marital dissolution or dissolution of a state registered domestic partnership;

(d) A transfer where a buyer had an ownership interest in the property within two years of the date of the transfer including, but not limited to, an ownership interest as a partner in a partnership, a limited partner in a limited partnership, a shareholder in a corporation, a leasehold interest, or transfers to and from a facilitator pursuant to a tax deferred exchange;

(e) A transfer of an interest that is less than fee simple, except that the transfer of a vendee's interest under a real estate contract is subject to the requirements of this chapter;

(f) A transfer made by the personal representative of the estate of the decedent or by a trustee in bankruptcy; and

(g) A transfer in which the buyer has expressly waived the receipt of the seller disclosure statement. However, if the answer to any of the questions in the section entitled "Environmental" would be "yes", the buyer may not waive the receipt of the "Environmental" section of the seller disclosure statement.

**G. ESTATE PLANNERS PLAY A VITAL ROLE IN THE APPRAISAL PROCESS.** See Section 2040, 2032, 2032(A), 1014(B)(6).

1. General Rule "Fair Market Value" – willing buyer, willing seller, highest and best use, with no compulsion to buy or sell

(a) Market Approach

(i) Actual sales

(ii) Comparable sales

(iii) Income approved

(iv) Cost approach

(v) Assessed value

2. Preserve the Availability of Stepped Up Basis under 1014(B)(6)

(a) It is a major goal (but it steps down also)

(b) However, planner should consider taking steps to preserve the basis of property that has declined in value in order to avoid a downward adjustment of basis upon the death of either spouse (i.e. Tenants in Common or Separate Property)

3. The IRS normally takes the position that in the absence of evidence to the contrary, the fact that the interest involved is a fractional interest does not warrant a discount. But case law has allowed up to 15% discounts (Propstra vs U.S. 680 F. 2nd 1248 (9th Circ. 1982).

4. Special Use Valuation of Real Estate Section 2032(A) – real property included in the descendant's estate which is devoted to farming or to closely held business use may be valued on the basis of the property's value as a farm or in the closely held business, rather than at its fair market value based on the highest and best uses. However, special use valuation cannot be used to reduce the decedent's gross estate by more than $1,020,000 for 2011. Rev. Proc 2010-40

(a) Qualification

(i) Qualified real property (US)

(ii) Being used on decedent death as a farm or used in a closely held trade or business other than farming

(iii) 50% or more of the adjusted value of the gross estate consists of real or personal property which is used for a qualified use (farming or trade or business)

(iv) 25% of adjusted value of gross estate consists of adjusted value of real property

(v) 5 – 8 years prior to decedent's death own by decedent or member of the decedent's family and

(vi) The property must pass to a qualified heir and a requisite agreement must be filed. Qualified heir defined as:

a. Individual ancestors
b. Spouse of individual
c. Lineal descendents of the individual, or the individuals spouse or of the individual's parents, and
d. Spouse of any descendent mentioned in (3)

(vii) Material participation by the decedent or a member of decedent's family

(b) IRC 2032 Special Use Valuation Property - property (under IRC 2032A) is to be made to a family entity prior to it's contribution its important to determine that the specially valued property "in its qualified use" will continue in the hands of the family entity, as determined by the partnership's purpose clause, and that the contribution does not constitute a taxable disposition for IRC § 2032A(c). Treas. Reg. 20..2032A-3(b) provides in pertinent part that property transferred from a proprietorship to a partnership during the 8-year period ending on the date of the decedent's death is considered to be continuously owned to the extent of the decedent's equity interest in the partnership if (i) the transfer meets the requirements of IRC § 721 (ii) the decedent's interest in the partnership is a IRC § 6166(b)(1) interest in a closely-held business.

(c) Recapture Period – 10 years, see IRC 2032A(c)(1), a cessation occurs if, within the recapture period, during any eight year period ending after the decedent's death and before the qualified heirs death there have been periods aggregating more than three (3) years during which there have been no material participation

5. Alternate Valuation Date

(a) Section 2032 provides that the alternate valuation date is the date six months after date of death

(b) If the alternate valuation date is elected, any property distributed, sold, exchanged or otherwise disposed of within six months after the date of death must be valued as of the date of distribution, sale, exchange or deposition

(c) Section 2032(c) only allows alternative valuation if the value of the gross estate is <u>less</u> than the value at the date of death

(d) The alternate valuation election must be made within one year after the time prescribed by law (including extensions), and once made, is irrevocable.

(e) By obtaining a six-month extension of time to file Form 706, pursuant to § 6081, which is now automatic, the executor may delay making the alternate valuation election until 27 months after the decedent's death (due date including extensions is 15 months from date of death plus the 12 months allowed by § 2032[d]).

**H. QUALIFICATION FOR SECTION 6166** – Section 6166 provides for an extension of time for the payment of estate tax where an estate consists of a specified percentage of one or more closely held business

(a) Closely held business must exceed 35% of the adjusted gross estate

(b) Get a 5 year deferral and 10 year installment payment

(c) Closely held business

(i) An interest as a proprietor in a trade or business carried on as a proprietorship

(d) An interest as a partner in a partnership carrying on a trade or business if 20% or more of the total capital interest in such partnership is included in determining the gross estate

2. The IRS has issued a number of private rulings on the question of whether real estate ownership qualifies as "an interest in a closely held business"

3. PLR 9015003 – Timber Business held in trust

4. TAM9635004 – Land used in cattle ranching

5. PLR 8020143 – interest in farm land held to be trade or business

6. PLR 20014005 – IRS ruled that a decedent's interest in 82 residential units constituted a single closely held business

7. PLR 19929025, IRS ruled that a decedent's interest in 33 properties and a wholly owned corporation constituted interest in a single closely held business for 6166 purposes

8. TAM 8451014 a decedent owned improved real estate that was used exclusively by one of his closely held corporations in the conduct of its business. The decedent leased the real estate to his closely held corporation on a net lease basis – the ruling held just a passive investment, not a trade or business. See also Rev Rule 2006-34 containing five hypothetical real estate closely held business guidelines.

**I. GIFTS - CHAPTER 14** - Be aware of Sections

1. 2701 – primarily dealing with gifts of equity interest in closely held corporations or partnership

2. 2702 transfers to trust

   (a) QPRT

   (b) GRAT – GRUTS

3. 2703 – Buy-Sell Agreements

**J. LIKE KIND EXCHANGE** – IRC § 1031 tax deferred exchange that is contributed to a family entity can result in a loss of the tax deferral and a triggering of capital gain where (i) the Service can successfully argue that the contributing partner/taxpayer intended to use the property to make gifts to his or her family members instead of holding the acquired property for use in a trade or business or for investment, and (ii) the property has not been held for use in a trade or business or for investment for at least two years since the date of the completion of the IRC § 1031 Exchange. Where gifts of interest in the family entity are made shortly after the property is contributed to the family entity, the Service has a strong argument for loss of the tax deferral. Also be aware of 1031(f), limitations of exchange between family members.

**K. MINERAL, OIL AND GAS RIGHTS AND INTEREST, WATER RIGHTS** – documents of title for these rights and interest should be carefully reviewed by someone who understands these rights and interests to determine if these interests can or should be transferred to any family entity. Joint operating agreements are very common. Many are "wasting assets" and give rise to environmental issues (may want to have separate entities hold these).

**L. PERSONAL RESIDENCE** - gain under Section 121 and 1034 if transferred to a family entity (see PLR 200 119014).

**M. HOW MANY FAMILY ENTITIES DICTATED BY:**

1. high degree of risk, environmental, contract or tort liability

2. single asset entity restructuring

3. where one or more children, grandchildren desire a particular asset

4. operating children – non-operating children

5. IRS attack risks

N. **LIQUIDITY ISSUES – INSURANCE PLANNING**

O. **FAMILY DYNAMIC ISSUES**

1. Sibling rivalry
2. Sibling mistrust
3. FVH issues
4. Potential for litigation

## III. OWNERSHIP STRUCTURE

**A. DIRECT** – fee simple - tenants in common, joint tenancy with right of survivorship, life estate in parents – remainder interest in kids

1. PROS

(a) Easily understood – can be made by Deed

(b) Less expensive

(c) Discounts for a gift or sale of a fractional interest in the FVH may be available to lower gift tax cost or gain on sale – Hedwick v Comm; T.C. Memo – 2010-104 TIC interested entitled to a 17% marketability discount

(d) If have only one or two children might be just fine

2. CONS

(a) Fractional ownership interest in a FVH may be subject to

(i) The claim of the parent's or children's creditors

(ii) Donee/children are younger less financially stable that the parent donor

(b) Expose to claims of a spouse in divorce

(i) Even if separate property if marital property used to pay mortgages, real estate taxes or contribution for improvements

(c) Not all family members are happy campers

(i) Disputes arise – some get disgruntled

(ii) Only recourse is Partition Action if agreement can't be reached

(iii) Lawsuits expensive

(d) Financial wherewithal of each family member may be different – some family members may get judgments, IRS problems, etc.

(e) Issues with Rev. Proc 2002-22 (is TIC respected as opposed to a partnership)

(f) Family members may not all have the same level of interest or responsibility

(g) Carryover basis – if the FVH were owned entirely by the parent would receive a full step up in income tax basis at death

(h) No Rights of First Refusal

(i) At some point, maybe with the second generation and almost inevitably the third generation, single or joint ownership becomes impossible

(j) TIC – everyone has a veto power – unmanageable

(k) Life estates and interests in property for a time of years are considered transfers in trust. See 2702(c) - treated as making a gift of entire value. Exception 2038 transfers subject to a retained power

## B. HOLDING THE FVH OR OTHER REAL ESTATE IN A TRUST

1. REVOCABLE – IRREVOCABLE LIVING TRUST

(a) PROS

(i) Easily accomplished by Deed – Revocable can be unwound

(ii) Grantor's Trust – so for income tax purposes payment of expenses and taxes is reported and deductible by the parent/grantor the same as if owned the FVH outright

(iii) If parent/grantor becomes disabled, successor trustee is pre-approved and ready to take over

(iv) Not subject to probate

(v) Freely amendable

(vi) Not subject to Washington inheritance tax if live out of state

(b) CONS

(i) Full Market Value of FVH will be included in the parent's/grantor's Revocable Living Trust

(ii) The Revocable Living Trust needs disposition plan after death of parent

(iii) Revocable Living Trust is generally not a good vehicle for multiple parties making capital contributions for improvements or for sharing expenses for maintenance

(iv) Who is the successor Trustee/Trustees

(v) Creditor protection is limited with a Revocable Living Trust. In most states creditors can attack assets held in a self-settled trust.

2. QPRT – allows the grantor to make a gift of a FVH to children while retaining use and enjoyment for a term of years.

(a) PROS

(i) Gift taxes are less than if made a gift of FVH outright in fee simple

(ii) Code Section 2702 and is relatively SAFE way of making gift – Grantor Trust

(iii) Parent can be Trustee

(b) CONS

(i) Total inclusion if parent/grantor dies during the QPRT term. May result in lost gift tax credit

(ii) At end of QPRT term, if parent grantor survives and occupies the home, must rent the FVH.

(iii) If the FVH is sold during the QPRT term, the net proceeds of the sale must be reinvested in a qualifying replacement home, or the arrangement must be converted to a Grantor Retained Annuity Trust ("GRAT").

(iv) Cannot hold any other assets (assets to fund taxes or maintenance exception: cash for trust expenses for 6 months)

3. IRREVOCABLE TRUST (GRATS/GRUTS) – See 2702

(a) PROS

(i) Creditor protection is generally better with an Irrevocable Trust.

(b) CON

(i) Amendments as they apply to Irrevocable Trusts – RCW 11.96A Trust and Estate Dispute Resolution Act ("TEDRA") RCW 11.96A.220 would probably allow amendments but would take <u>unanimous consent</u>. RCW 11.96A.160 provides for the appointment of a guardian ad litem to represent the interests of a minor, incapacitated, unborn or unascertained person, or a person whose identity or address is unknown.

(ii) Who is the Trustee – with representation with extended family lines or generations

(iii) Term-Expiration of Trust

(iv) Contribution of funds create gift tax issues if to an Irrevocable Trust – Crummey Provisions

(v) Beneficiaries have no say in Trust terms

## C. FAMILY LIMITED PARTNERSHIP (FLP) OR FAMILY LIMITED LIABILITY COMPANY (LLC)

1. PROS

(a) Retention of control by the Parents

(b) Gifts of minority interests easier that an individual interests in the real estate

(c) Most LLC & FLP have provisions giving non-transferring partners the ability to purchase when a voluntary transfer to a non-family member is contemplated

(d) Need a charging order – asset protection good – a creditor of a member can't satisfy his claim against LLC or FLP when the FVH is owned by the entity. RCW 25 provides: On application to a court of competent jurisdiction by any judgment creditor of a partner or transferee, the court may charge the transferable interest of the judgment debtor with payment of the unsatisfied amount of the judgment with interest to the extent so charged, the judgment creditor has only the rights of a transferee. The second sentence is the key asset protection language in the statute: "the judgment creditor has only the rights of a transferee", meaning that the charging order remedy may be viewed as judicial assignment of a partner's interest in the partnership. Thus: (i) the charging order does not entitle the creditor to become a limited partner; (ii) the charging order does not entitle the creditor to vote on partnership matters; and (iii) the charging order does not entitle the creditor to inspect or copy partnership records, or even to obtain the limited partnership's business and tax information which is usually available.

(e) Keep from commingling assets in a marriage. It is easier to maintain LLC or FLP interests as separate non-marital property.

(f) Can be amended

(g) LLC combines the partnership benefits of pass-through tax attributes and flexibility of structure with the corporate benefit of limited liability for all members

(h) Termination of LLC or FLP not adverse tax consequences of corporation

(i) FLP or LLC membership interests transferred to Revocable Trust

(j) Provide for arbitration or mediation

(k) Make annual exclusion gifts

(l) Can use lack of control and marketability discounts. Congress has introduced legislation to provide that no valuation discounts will be allowed for transfers to family members in an entity that holds FVH or other real estate.

(m) Easy vehicle to have other income producing assets – to help pay for cost of maintaining FVH.

(n) Forming FLP may have state estate tax benefits – FLP or LLC interests are intangible personal property and generally subject to estate or other death tax only in the state of decedent's domicile.

(o) Third generation – more likely to be more distant from each other, both experientially and geographically.

(p) Do you do it on family lines – succession planning to next generation is easily. Voting power and control can be determined.

2. CONS

(a) If managed LLC, or Family Limited Partnership issues of 2036 – retained life interest. See 2036(a) and 2036 (a)(2) (right to designate the person who possess or enjoy the property or the income therefrom.)

(b) Gifts of FLP or LLC interests generally are present interest gifts qualifying for tax annual exclusion. But see Hackl v. Commissioner – gift tax annual exclusion denied.

(c) Forming an entity will, whether in Idaho or Washington, create inheritance tax issues in Washington because it is now deemed Washington personal property if you are a Washington resident.

### D. CORPORATIONS: "S" OR "C"

## IV. ISSUES TO BE ADDRESSED IN OPERATING OR USE AGREEMENTS

**A. INFORMAL & FORMAL USE AGREEMENTS** - Mother says "Talk it out, just truly listen to each other with love in your heart."

### B. AGREEMENTS FOR FVH SHOULD PROVIDE FOR:

1. Duties, responsibilities, and payment for routine regular maintenance

2. Duties, responsibilities, and payment for extraordinary maintenance

3. Responsibility for payment of regular operating expenses/mortgage or mortgages

4. Schedule of personal and rental use of FVH

5. Sale of FVH and division of personal property

   (a) Right of First Refusal

   (b) Self financing

6. Majority or Supermajority vote

7. Payment or outsourced to third party independent contractors

   (a) Who does the work

   (b) Who opens and closes

   (c) Does someone get better slot or weeks for doing the work

8. If FVH is to be rented these questions need to be answered

   (a) Will an outside rental agency be renting?

   (b) What will rental rates be?

   (c) What will commission be?

(d) What will block out times be?

(e) Insurance coverage?

9. Term of Agreement

10. How many weeks or slots per summer and how long to each slot

11. How is allocation of slots determined and by whom

12. Are certain slots more valuable than others – if you get one of these do you have to give up other advantages

13. If I can't take my slot – can I rent my slot, or trade it (like a time share)

14. As the next generation comes along, at what point, i.e. marriage or death of parents, do they get to have their own slot as opposed to sharing with their parents

15. How do you forestall ruinous inheritance taxes

16. What happens if one family unit, due to loss of job, severe illness, etc, is unable to pay their yearly share

17. If one family unit wants to be bought out, can this be required of the other members

18. Will a sell out to non-family be prohibited

19. Do daughters & sons-in-laws get to inherit

20. Does divorce allow the property to go to outside family members

21. How are capital calls made – what if they are not made

22. Who decides if the house is remodeled, expanded, torn down or rebuilt

23. What about boats, docks and other personal property

24. If someone breaks the stove, TV or other appliances do they have to replace

25. How and by whom is it decided when furnishing and furniture must be replaced and with what

26. How should those handling the responsibilities mentioned above be compensated with slot time, if at all

27. Sweat – what is it worth

28. Who keeps log of tasks to be completed

29. What about pets – what if certain members have animal allergies and or little children

30. Will sensible environmental practices be required – low phosphate detergents

31. What about amendments to agreements

## V. CONCLUSIONS

1. Real Estate – unique assets without liquidity and not fungible. At least for FVH, work out most of details of your agreement before consulting the attorney – you do not need an attorney to decide for you how to allocate summer slots

2. Provide endowment (of other assets) to cover anticipated taxes, mortgages and maintenance costs.

   (a) Remember endowment may be inadequate

3. Trust are not easily amended as conditions may warrant

4. LLC & FLP – any formal agreement must anticipate the increase in family size that will occur as other generations come along

5. Need use and maintenance agreements also

6. Risk of Lawsuits – don't want to have Partnership, or Co-Tenancy – need Trust or LLC

7. Don't like corporations – not as flexible either C or S corps

8. Formal agreement take a lot longer than you can imagine

9. It will be frustrating and infuriating – REQUIRES PATIENCE, TOLERANCE AND FAMILY MEMBER COOPERATION

10. Work to include all family members with any degree of maturity and build consensus

11. Recognize in-laws and silent partners and in many cases do all of the work.

12. Keep gender bias out of the process

13. The process will bring up old problems, wounds, conflicts and more likely than not tears

14. Learn to forgive, be understanding, forward thinking, patient, concerned for others in the family. Become a patron saint of serenity, wisdom and understanding

15. Family Mission Statement – maximize family benefit from shared use of the place.

16. It may be better for the family to sell the FVH, give the dollars to the kids and let them all go their separate ways

17. **OWNERSHIP, INHERITANCE AND SUCCESSION PLANNING OF REAL ESTATE ARE KEY MATTERS THAT THE ENTIRE ESTATE PLANNING TEAM NEEDS TO BE MARSHALED TO ADDRESS.**

## REAL ESTATE EXCISE TAX WACS

**WAC 458-61A-101** - Taxability of the transfer or acquisition of the controlling interest of an entity with an interest in real property located in this state.

**(1) Introduction**. The transfer of a controlling interest in an entity that has an interest in real property in this state is considered a taxable sale of the entity's real property for purposes of the real estate excise tax under chapter 82.45 RCW. This rule explains the application of the tax on those transfers.

**(2) Definitions**. For the purposes of this chapter, the following definitions apply unless the context requires otherwise

(a) "Controlling interest" means:

(i) In the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of the corporation entitled to vote, or fifty percent of the capital, profits, or beneficial interest in the voting stock of the corporation; and

(ii) In the case of a partnership, association, trust, or other entity, fifty percent or more of the capital, profits, or beneficial interest in such partnership, association, trust, or other entity.

**Examples**. The following examples, while not exhaustive, illustrate some of the circumstances in which the transfer of an interest in an entity may or may not be taxable. These examples should be used only as a general guide. The status of each situation must be determined after a review of all of the facts and circumstances.

(A) Able and Baker each own 40% of the voting shares of a corporation, Flyaway, Inc. Charlie, Delta, Echo, and Frank each own 5% voting shares. Charlie acquires Baker's 40% interest, and Delta's and Echo's 5% interests. This is a taxable acquisition because a controlling interest (50% or more) was acquired by Charlie (40% from Baker plus 5% from Delta and 5% from Echo). However, if Charlie, Delta, and Echo were to transfer their shares (totaling 15%) to Able, those transfers would not be taxable. Although Able would own 55% of the corporation, only a 15% interest was transferred and acquired, so the acquisition by Able is not taxable.

(B) Melody LLC consists of a general partner and three limited partners, each possessing a 25% interest. Even though the general partner controls the management and daily operations, a 25% interest is not a controlling interest. If someone were to acquire a 50% or greater interest from any of the existing partners, there would be a taxable acquisition of a controlling interest. If one partner acquires an additional 25% interest from another partner for a total of a 50% interest, no transfer or acquisition of a controlling interest occurs because less than 50% is transferred and acquired.

(C) Anne, Bobby, Chelsea, and David each own 25% of the voting shares of a corporation. The corporation redeems the shares of Bobby, Chelsea, and David. Anne

now owns all the outstanding shares of the corporation. A taxable transfer occurred when the corporation redeemed the shares of Bobby, Chelsea, and David.

(D) Andrew owns 75% of the voting shares of a corporation. Andrew transfers all of his stock by 25% portions of the shares in three separate and unrelated transactions to Betsy, Carolyn, and Daniel, who are not acting in concert. A taxable transfer of a controlling interest occurs when Andrew transfers 75% of the voting shares of the corporation, even though no one has subsequently acquired a controlling interest.

(E) Big Corporation has two stockholders, Adrian and Britain. Adrian owns 90 shares of stock (90%) and Britain owns 10 shares of stock (10%). Big Corporation owns 60% of the stock of Little Corporation, which owns real property. Adrian, by virtue of owning 90% of Big Corporation's stock, has a 54% interest in Little Corporation (90% interest in Big multiplied by the 60% interest Big has in Little equals the 54% interest Adrian has in Little). Adrian sells his 90 shares of stock in Big to Britain. Adrian, by selling his 90 shares of Big stock, has transferred a controlling interest (54%) in an entity that owns real property (Little). This transfer is subject to the real estate excise tax.

(F) Assume the same facts as in Example (E) of this subsection, except that Big owns only 50% of Little's stock. Since Adrian has not transferred and Britain has not acquired a controlling interest in Little (90% x 50% = 45%), the real estate excise tax does not apply. If, however, Big had transferred its 50% interest in Little, that would be a transfer of a controlling interest and it would be subject to the real estate excise tax.

(b) The terms "person" or "company" mean any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, co-partnership, joint venture, club, company, joint stock company, business trust, municipal corporation, the state of Washington or any political subdivision thereof, corporation, limited liability company association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise, and the United States or any agency or instrumentality thereof.

(c) "True and fair value" means market value, which is the amount of money that a willing, but unobliged, buyer would pay a willing, but unobligated, owner for real property, taking into consideration all reasonable, possible uses of the property.

(d) "Twelve-month period" is any period of twelve consecutive months and may span two calendar years.

(e) "Acting in concert" occurs:

(i) When one or more persons have a relationship with each other such that one person influences or controls the actions of another through common ownership. For example, if a parent corporation and a wholly owned subsidiary each purchase a 25% interest in an entity, the two corporations have acted in concert and acquired a controlling (i.e., at least 50%) interest in the entity.

(ii) Where buyers are not commonly controlled or owned, but the unity of purpose with which they have negotiated and will complete the acquisition of ownership interests, indicates that they are acting together. For example, three separate individuals who decide together to acquire control of a company jointly through separate purchases of 20% interests in the company act in concert when they acquire the interests.

**(3) In general**. In order for the tax to apply when the controlling interest in an entity that owns real property is transferred, the following must have occurred:

(a) The transfer or acquisition of the controlling interest occurred within a twelve-month period;

(b) The controlling interest was transferred in a single transaction or series of transactions by a single person or acquired by a single person or a group of persons acting in concert;

(c) The entity has an interest in real property located in this state;

(d) The transfer is not otherwise exempt under chapters 82.45 RCW and 458-61A WAC; and

(e) The transfer was made for valuable consideration.

**(4) Measure of the tax**. The measure of the tax is the "selling price." For the purpose of this rule, "selling price" means the true and fair value of the real property owned by the entity at the time the controlling interest is transferred.

(a) If the true and fair value of the property cannot reasonably be determined, one of the following methods may be used to determine the true and fair value:

(i) A fair market value appraisal of the property; or

(ii) An allocation of assets by the seller and the buyer made pursuant to section 1060 of the Internal Revenue Code of 1986, as amended or renumbered as of January 1, 2005.

(b) If the true and fair value of the property to be valued at the time of the sale cannot reasonably be determined by either of the methods in (a) of this subsection, 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.

(c) Examples.

(i) A partnership owns real property and consists of two partners, Amy and Beth. Each has a 50% partnership interest. The true and fair value of the real property owned by the partnership is

$100,000. Amy transfers her 50% interest in the partnership to Beth for valuable consideration. The taxable selling price is the true and fair value of the real property owned by the partnership, or $100,000.

(ii) A corporation consists of two shareholders, Chris and Dilbert. The assets of the corporation include real property, tangible personal property, and other intangible assets (goodwill, cash, licenses, etc.). An appraisal of the corporation's assets determines that the values of the assets are as follows: $250,000 for real property; $130,000 for tangible personal property; and $55,000 for miscellaneous intangible assets. Chris transfers his 50% interest to Ellie for valuable consideration. The taxable selling price is the true and fair value of the real property owned by the corporation, or $250,000.

(iii) An LLC owns real property and consists of two members, Frances and George. Each has a 50% LLC interest. Frances transfers her 50% interest to George. In exchange for the transfer, George pays Frances $100,000. The true and fair value of the real property owned by the LLC is unknown. There is no debt on the real property. A fair market value appraisal is not available. The market value assessment for the property maintained on the county property tax rolls is $275,000. The taxable selling price is the market value assessment, or $275,000.

**(5) Persons acting in concert**. The tax applies to acquisitions made by persons acting in concert, as defined in subsection (2)(f) of this section.

(a) Where persons are not commonly controlled or influenced, factors that indicate whether persons are acting in concert include:

(i) A close relation in time of the transfers or acquisitions;

(ii) A small number of purchasers;

(iii) Mutual terms contained in the contracts of sale; and

(iv) Additional agreements to the sales contract that bind the purchasers to a course of action with respect to the transfer or acquisition.

(b) If the acquisitions are completely independent, with each purchaser buying without regard to the identity of the other purchasers, then the persons are not acting in concert, and the acquisitions will be considered separate acquisitions.

(c) Example. Able owns 100% of Emerald Corporation, which owns real property. As a group, Baker, Charlie, Delta, and Echo negotiate to acquire all of Able's

interest in Emerald. Baker, Charlie, Delta, and Echo each acquire 25% of Able's interest. The contracts of Baker, Charlie, Delta, and Echo are identical and the purchases occur simultaneously. Baker, Charlie, Delta, and Echo also negotiated an agreement binding themselves to a course of action with respect to the acquisition of Emerald and the terms of the shareholders agreement that will govern their relationship as owners of Emerald. Baker, Charlie, Delta, and Echo are acting in concert and their acquisitions from Able are treated as a single acquisition of a controlling interest that is subject to the real estate excise tax.

**(6) Date of sale.**

(a) When the controlling interest is acquired in one transaction, the actual date control is transferred is the date of sale. Examples of when an interest in an entity is transferred include when payment is received by the seller and the shares of stock are delivered to the buyer, or when payment is received by the seller and partnership documents are signed, etc. However, if the parties enter into an agreement to acquire or transfer a controlling interest over time through a series of transactions, the date of sale is deemed the date of the agreement arranging the transactions. The agreement results in the transfer of both a present interest and a beneficial interest in the entity, the sum of which results in a controlling interest, regardless of whether the first of the successive transactions is more than twelve months prior to the final transaction.

(b) Examples.

(i) Andrew owns 100% of the voting shares of Topaz Corporation. Andrew signs a binding agreement to transfer 51% of his shares in the corporation to Ted. The agreement states that the transfer will occur as follows: 49% of the shares will be transferred on January 1st, and the remaining 2% of the shares will be transferred on February 1st of the following year. Andrew has contractually agreed to sell 51% of the voting shares in Topaz within a twelve-month period, even though the shares will not actually be transferred to Ted until later. The date of sale is the date of the agreement, and REET is due upon the true and fair value of the property as of the date of the agreement.

(ii) Matt acquires a 10% interest in an entity which owns an apartment building under construction worth $500,000 from Simon on January 30th. On July 30th Matt acquires a 30% interest in the same entity from Mary, but the building is now worth $900,000. On September 30th Matt acquires a 10% interest in the same entity from Ruth, but the building is now worth $1,000,000. These are three separate and completely independent transfers. The final transfer allowed Matt to acquire, within twelve months, a controlling interest in an entity that owns real property. September 30th is the date of sale.

To determine the sellers' proportional tax liability in the example above, the series of transactions is viewed as a whole. Note both the individual and the total interests transferred. Here, Simon and Mary each conveyed 10% interests, while Ruth conveyed a 30% interest, with a total of a 50% interest being conveyed. To determine the liability percentage for each seller, divide the interest each conveyed by the total interest conveyed (Here, Simon and Mary: 10/50 = 20%; Ruth: 30/50 = 60%). This results in tax liability percentages here for Simon and Mary of 20% each and for Ruth, 60%.

To determine the amount of tax owed, the percentage is applied to the value of the property at the time of conveyance. In the example above, the value of the property to which the percentage applies is dependent on the time of each transfer (i.e., Simon's 20% on the $500,000; Mary's 60% on the $900,000; Ruth's 20% on the $1,000,000).

**(7)** **Tax liability**. When there is a transfer or acquisition of a controlling interest in an entity that has an interest in real property, the seller of the interest is generally liable for the tax.

(a) When the seller has not paid the tax by the due date and neither the buyer nor the seller has notified the department of the sale within thirty days of the sale, the buyer is also liable for the tax.

(b) When the buyer has notified the department of the sale within thirty days of the sale, the buyer will not be held personally liable for any tax due.

**(8)** **Reporting requirements**. The transfer of a controlling interest in real property must be reported to the department when no instrument is recorded in the official real property records of the county in which the property is located. If the transfer is not taxable due to an exemption, that exemption should be stated on the affidavit.

(a) The sale must be reported by the seller to the department within five days from the date of the sale on the department of revenue affidavit form, DOR Form 84-0001B. The affidavit form must be signed by both the seller and the buyer, or their agent, and must be accompanied by payment of the tax due.

(b) The affidavit form may also be used to disclose the sale, in which case:

(i) It must be signed by the person making the disclosure; and

(ii) It must be accompanied by payment of the tax due only when submitted by a seller reporting a taxable sale.

(c) Any person who intentionally makes a false statement on any return or form required to be filed with the department under this chapter is subject to penalty of perjury.

(d) Examples. The following examples, while not exhaustive, illustrate some of the circumstances in which the transfer of an interest in an entity must be reported to the department. These examples should be used only as a general guide. The status of each situation must be determined after a review of all of the facts and circumstances.

(i) Simon and Peter each own 40% of the voting shares of a corporation. Paul, Matthew, Mark, and John each own 5% voting shares. Paul acquires Peter's 40% interest, and Matthew's and Mark's 5% interests. This is a taxable acquisition because a controlling interest (50% or more) was acquired by Paul (40% from Peter plus 5% from Matthew and 5% from Mark). This transaction must be reported.

(ii) Assume same facts as in example (d)(i) of this subsection. Paul's attorney advises him that for his protection, Paul should file an affidavit to disclose the sale. Paul files an affidavit to disclose the sale to the department within thirty days of the date of sale. Peter, Matthew, and Mark go on vacation and the affidavit and required tax payment is not sent to the department. The department notifies Peter, Matthew, and Mark of their tax liability, which now includes interest and penalties. Due to Paul's disclosure, Paul is relieved of any personal liability for the tax, interest, or penalties.

(iii) Assume the same facts as in example (d)(i) of this subsection, except Paul only acquires Peter's 40% interest and Matthew's 5% interest. This is not a taxable acquisition because a controlling interest (50% or more) was not acquired by Paul. This transaction does not need to be reported.

**(9) Due date, interest and penalties**. The tax imposed is due and payable immediately on the date of sale. See WAC 458-61A-306 for interest and penalties that may apply.

**(10) Transfers after tax has been paid**. When there is a transfer or acquisition of a controlling interest in an entity and the real estate excise tax is paid on the transfer, and there is a subsequent acquisition of an additional interest in the same entity within the same twelve-month period by a person acting in concert with the previous buyer(s), the subsequent seller is liable for its proportional portion of the tax. After payment by the subsequent seller of its proportional share, the person(s) who previously paid the tax may apply to the department for a refund of the amount overpaid because of the new proportional amount paid as a result of the subsequent transfer or acquisition.

**(11) Exemptions**. Because transfer and acquisition of a controlling interest in an entity that owns real estate in this state is statutorily defined as a "sale" of the real property owned by the entity, the exemptions of chapter 82.45 RCW and this chapter also apply to the sale of a controlling interest.

**Examples**.

(A) The merger of a wholly owned subsidiary owning real property located in this state with another subsidiary wholly owned by the same parent is a transfer of a controlling interest. However, this transfer may be exempt from taxation on two grounds.

First, it may be exempt because it is a mere change in form or identity (see WAC 458-61A-211). Second, it may be exempt if it qualifies under the nonrecognition of gain or loss provisions of the Internal Revenue Code for entity formation, liquidation and dissolution, and reorganization. (See WAC 458-61A-212.)

(B) Taki owns 100% of a corporation. Taki wants her child, Mieko, and corporate manager, Sage, to be co-owners with her in the corporation. Taki makes a gift of 50% of the voting stock to Mieko and sells 33 1/3% to Sage. Although a controlling interest in the corporation has been transferred to and acquired by Mieko, it is not taxed because a gift is an exempt transfer and not considered for purposes of determining whether a controlling interest has transferred. The sale of the 33 1/3% interest to Sage is not a controlling interest, and is not taxed.

(C) Richard owns 75% of the voting stock of a corporation that owns real estate located in this state. Richard pledges all of his corporate stock to secure a loan with a bank. When Richard defaults on the loan and the bank forecloses on Richard's stock in the corporation, the transfer and acquisition of the controlling interest of the entity is not a taxable transaction because foreclosures of mortgages and other security devices are exempt transfers. (See WAC 458-61A-208.)

**WAC 458-61A-103** Transfers involving an underlying debt.

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

For example, Yen transfers property to Lee that is subject to an underlying debt. Yen is personally liable for the debt, meaning that if Yen does not make the payments the lender may foreclose on the property and obtain a judgment against Yen if the value of the property is insufficient to pay the debt. Lee agrees to make all future payments on Yen's debt but gives no other consideration for the property. Yen owes real estate excise tax on the amount of the underlying debt. Lee's payments on the underlying debt relieve Yen of her debt obligation. Therefore, Yen receives consideration.

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

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

**(3) Documentation**. In order to avoid the incidence of the tax, the grantor must present and maintain proper documentation to verify the type of debt and to confirm that fact that the grantor is not personally liable for the debt.

**WAC 458-61A-201** Gifts.

**(1) Introduction**. Generally, a gift of real property is not a sale, and is not subject to the real estate excise tax. A gift of real property is a transfer for which there is no consideration given in return for granting an interest in the property. If consideration is given in return for the interest granted, then the transfer is not a gift, but a sale, and it is subject to the real estate excise tax to the extent of the consideration received.

**(2) Consideration**. See WAC 458-61A-102 for the definition of "consideration." Consideration may also include:

(a) Monetary payments from the grantee to the grantor; or

(b) Monetary payments from the grantee toward underlying debt (such as a mortgage) on the property that was transferred, whether the payments are made toward existing or refinanced debt.

**(3) Assumption of debt**. If the grantee agrees to assume payment of the grantor's debt on the property in return for the transfer, there is consideration, and the transfer is not exempt from tax. Real estate excise tax is due on the amount of debt assumed, in addition to any other form of payment made by the grantee to the grantor in return for the transfer. However, equity in the property can be gifted.

**(4) Rebuttable presumption regarding refinancing transactions**.

(a) There is a rebuttable presumption that the transfer is a sale and not a gift if the grantee is involved in a refinance of debt on the property within six months of the time of the transfer.

(b) There is a rebuttable presumption that the transfer is a gift and not a sale if the grantee is involved in a refinance of debt on the property more than six months from the time of the transfer.

**(5) Documentation**.

(a) A completed real estate excise tax affidavit is required for transfers by gift. A supplemental statement approved by the department must be completed and attached to the affidavit. The supplemental statement will attest to the existence or absence of underlying debt on the property, whether the grantee has or will in the future make any payments on the debt, and whether a refinance of debt has occurred or is planned to occur. The statement must be signed by both the grantor and the grantee.

(b) The grantor must retain financial records providing proof that grantor is entitled to this exemption in case of audit by the department. Failure to provide records upon request will result in subsequent denial of the exemption.

**(6) Examples**.

(a) Overview. The following examples, while not exhaustive, illustrate some of the circumstances in which a grant of an interest in real property may qualify for this exemption. These examples should be used only as a general guide. The taxability of each transaction must be determined after a review of all the facts and circumstances.

(b) Examples - No debt.

(i) John conveys his residence valued at $200,000 to Sara. John comes off of the title. There is no underlying debt on the property, and Sara gives John no consideration for the transfer. The conveyance from John to Sara qualifies for the gift exemption from real estate excise tax.

(ii) Keith and Jean, as joint owners, convey their residence valued at $200,000 to Jean as her sole property. There is no underlying debt on the property. In exchange for Keith's one-half interest in the property, Jean gives Keith $10,000. Keith has made a gift of $90,000 in equity, and received consideration of $10,000. Real estate excise tax is due on the $10,000.

(c) Examples - Existing debt.

(i) Josh conveys his residence valued at $200,000 to Samantha. Josh has $25,000 in equity and an underlying debt of $175,000. Josh continues to make the mortgage payments out of his own funds, and Samantha does not contribute any payments toward the debt. Since Josh continues to make the payments, there is no consideration from Samantha to Josh, and the transfer qualifies for exemption as a gift.

(ii) Josh conveys the residence to Samantha, and after the transfer, Samantha begins to make payments on the debt. Josh does not contribute to the payments on the debt after the title is transferred. Josh has made a gift of his $25,000 equity, but real estate excise tax is due on the $175,000 debt that Samantha is now paying.

(iii) Dan conveys his residence valued at $200,000 to himself and Jill as tenants in common. Dan has $25,000 in equity and an underlying debt of $175,000. Dan and Jill open a new joint bank account, to which they both contribute funds equally. Mortgage payments are made from their joint account. There is a rebuttable presumption that real estate excise tax is due on the conveyance because Jill appears to be contributing toward payments on the debt. In that case, real estate excise tax is due on the consideration given by Jill, (50% of the underlying debt) based upon her contributions to the joint account. The tax will be calculated on a one-half interest in the existing debt ($87,500).

(iv) Dan conveys the residence to himself and Jill. Dan has $25,000 in equity, and a mortgage of $175,000. Dan and Jill open a new joint bank account, which is used to make the mortgage payments, but Dan contributes 100% of the funds to the account. The conveyance is exempt from real estate excise tax, because Jill has not given any consideration in exchange for the transfer.

(v) Bob conveys his residence valued at $200,000 to himself and Jane as tenants in common. Bob has $25,000 equity, and an underlying debt of $175,000. Bob and Jane have contributed varying amounts to an existing joint bank account for many years prior to the conveyance. Mortgage payments have been made from the joint account both before and after the transfer. The conveyance is exempt from real estate excise tax, because Jane's contributions toward the joint account from which the payments are made is not deemed consideration in exchange for the transfer from Bob (because she made contributions for many years before the transfer as well as after the transfer, there is no evidence that her payments were consideration for the transfer).

(vi) Bill and Melanie, as joint owners, convey their residence valued at $200,000 to Melanie, as her sole property. There is an underlying debt of $170,000. Prior to the transfer, both Bill and Melanie had contributed to the monthly payments on the debt. After the transfer, Melanie begins to make 100% of the payments, with Bill contributing nothing toward the debt. Bill's equity ($15,000) is a gift, but Melanie's taking over the payments on the mortgage is consideration received by Bill. Real estate excise tax is due on $85,000 (Bill's fractional interest in the property multiplied by the outstanding debt at the time of transfer: 50% x $170,000).

(vii) Casey and Erin, as joint owners, convey their residence to Erin. There is an underlying debt of $170,000 in both their names. For the three years prior to the transfer, Erin made 100% of the payments on the debt. After the transfer, Erin continues to make 100% of the payments. The transfer is exempt from the real estate excise tax because Erin made all the payments on the property before the transfer as well as after the transfer; there is no evidence that her payments were consideration for the transfer.

(d) Examples -- Refinanced debt.

(i) Bob conveys his residence to himself and Jane. Within one month of the transfer, Bob and Jane refinance the underlying debt of $175,000 in both their names, but Bob continues to make the payments on the debt. Jane does not contribute any funds toward

the payments. The conveyance qualifies for the gift exemption because Jane gave no consideration for the transfer.

(ii) Casey and Erin, as joint owners, convey their residence valued at $200,000 to Erin as sole owner. There is an underlying mortgage on the property of $170,000. Prior to the transfer, Casey and Erin had both contributed to the monthly mortgage payments. Within one month of the transfer, Erin refinances the mortgage in her name only and begins to make payments from her separate account. In this case, there is a rebuttable presumption that this is a disguised sale, since Erin, through her refinance, has assumed sole responsibility for the underlying debt. Real estate excise tax is due on $85,000 (Casey's fractional interest in the property multiplied by the total debt on the property: 50% x $170,000).

(iii) Kyle conveys his residence valued at $200,000 to himself and Amy as tenants in common. Kyle has $25,000 in equity, and an underlying debt of $175,000. Within one month of the transfer, Kyle and Amy refinance the mortgage in both their names, and open a joint bank account to which they contribute funds equally. Payments on the new mortgage are made from the joint account. There is a rebuttable presumption that Amy's contributions to the joint account are consideration for the transfer, since Amy appears to have agreed to pay half of the monthly debt payment, and real estate excise tax may be due. The measure of the tax is one-half of the underlying debt to which Amy is contributing ($87,500).

(iv) Kyle conveys his residence to himself and Amy. Kyle continues to make the payments on the underlying debt of $175,000. Nine months after the transfer, Kyle and Amy refinance the property in both of their names. After the refinance, Kyle and Amy contribute equally to a new joint bank account from which the mortgage payments are now made. Amy's contribution to the mortgage nine months after the transfer is not deemed consideration in exchange for the transfer from Kyle to the two of them as tenants in common. The conveyance will qualify for the gift exemption.

(e) Example -- Refinanced debt -- "Cosigner." Charlie and Sadie, a married couple, own a residence valued at $200,000 with an underlying mortgage of $170,000. Sadie receives the property when they divorce. After a few months, Sadie tries to refinance, but her credit is insufficient to obtain a loan in her name only. Aunt Grace offers to assist her by becoming a "co-borrower" on the loan. As a result, the bank requires that Aunt Grace be added to the title. Following the refinance, Sadie makes 100% of the payments on the new debt, and Aunt Grace gives no consideration for being added to the title. The conveyance adding Aunt Grace to the title is exempt from real estate excise tax. Although the quitclaim deed from Sadie to Aunt Grace may be phrased as a gift, the transfer is exempt as Aunt Grace's presence on the title acts as an exempt

security interest to protect Aunt Grace in the event Sadie defaults on her mortgage. See WAC 458-61A-215 for this exemption.

(f) Example -- Rental or commercial property. Sue owns a rental property valued at $200,000, with an underlying mortgage of $175,000. Sue conveys the property to herself and Zack as tenants in common. Prior to the transfer, the rental income went to a bank account in Sue's name only, and she made the mortgage payments from that account. After the transfer, Zack's name is added to the bank account. The rental income is now deposited in the joint account, and the mortgage payments are made from that account. There is a rebuttable presumption that this is a taxable transaction, because this appears to be a business arrangement. As a business venture, one-half of the rental income now belongs to Zack, and is being contributed toward payment of the mortgage. The real estate excise tax will be due on the one-half interest of the debt contributed by Zack ($87,500).

**WAC 458-61A-212** Transfers where gain is not recognized under the Internal Revenue Code.

**(1) Introduction**. A transfer that, for federal income tax purposes, does not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization, is not subject to the real estate excise tax.

**(2) Internal Revenue Code sections**. This exemption includes, but is not limited to, nonrecognition of loss or gain under the following sections of the Internal Revenue Code of 1986:

(a) Section 332 - Corporate liquidations - Complete liquidations of subsidiaries.

(b) Section 337 - Corporate liquidations - Nonrecognition for property distributed to parent in complete liquidation of subsidiary.

(c) Section 351 - Corporate organizations and reorganizations - Transfer to corporation controlled by transferor.

(d) Section 368 (a)(1) - Corporate organizations and reorganization - Definitions relating to corporate reorganizations - Reorganizations - In general.

(e) Section 721 - Partners and partnerships - Nonrecognition of gain or loss on contribution.

(f) Section 731 - Partners and partnerships - Extent of recognition of gain or loss on distribution.

**(3) Extent of exemption**. This exemption applies only to transfers that qualify as nonrecognition of gain or loss transactions under the Internal Revenue Code for entity formation, liquidation or dissolution, and reorganization.

(a) This exemption does not apply to transactions under Internal Revenue Code section 1031 - Exchange of property held for productive use or investment. That section of the Internal Revenue Code does not deal with entity formation, liquidation or dissolution, or reorganization. (See WAC 458-61A-213, IRS "tax deferred" exchanges.)

(b) This exemption does not apply to sales under Internal Revenue Code section 1034 - Rollover of gain on sale of principal residence. That section of the Internal Revenue Code does not deal with entity formation, liquidation or dissolution, or reorganization.

**(4) Treatment when gain is partially recognized in an otherwise exempt transaction**. In the event a transaction qualifies for the exemption under this section as a nonrecognition of gain or loss transaction for entity formation, liquidation or dissolution, or reorganization, but a gain is partially recognized under the Internal Revenue Code provisions, the real estate excise tax applies to the amount of the transaction for which gain is recognized.

**(5) Examples**. The following examples, while not exhaustive, illustrate some of the circumstances in which a grant of an interest in real property may or may not qualify for exemption under this rule. These examples should be used only as a general guide. The taxability of each transaction must be determined after a review of all the facts and circumstances.

(a) In an otherwise nontaxable Internal Revenue Code section 351 transaction, Nate transfers to ZULU Corporation real property which has a true and fair value of $100,000. Nate receives, in exchange, ZULU stock worth $80,000, cash of $5,000, and a promissory note from ZULU to pay Nate $15,000 monthly, starting at closing, for 36 months at 6% interest. The $5,000 cash received and the $15,000 promissory note constitute "boot" under the provisions of section 351 and gain is recognized to the extent of the "boot." For real estate excise tax purposes, the taxable portion is 20% ($20,000/$100,000) and the real estate excise tax applies to 20% of the true and fair value of the real property transferred, or $20,000.

(b) In an otherwise nontaxable Internal Revenue Code section 351 transaction, Sally transfers real property with a true and fair value of $50,000, and machinery worth $250,000, to ECHO Corporation. In exchange, Sally receives ECHO stock worth $275,000 and cash of $25,000. The cash received constitutes "boot" and gain is recognized. For real estate excise tax purposes, the nonexempt portion of the transaction is 8.3% ($25,000/$300,000). The nonexempt percentage (8.3%) is applied to the true and fair value of the real property ($50,000) to arrive at the amount $4,167. Real estate excise tax is due on $4,167.

(c) Brenda and Julie are partners in LIMA Partnership. In a nontaxable Internal Revenue Code section 721 transaction, Mike transfers real property to LIMA Partnership in exchange for a partnership interest in LIMA Partnership. No consideration, other than the partnership interest in LIMA Partnership, is given to Mike in exchange for Mike's transfer of real property. Because the transfer is exempt under Internal Revenue Code section 721, the real estate excise tax does not apply to Mike's conveyance of real property to LIMA partnership.

(d) Brenda and Julie are also partners in GOLF Partnership. In a nontaxable Internal Revenue Code section 721 transaction, Mike contributes cash to GOLF Partnership in exchange for a 60% partnership interest in GOLF Partnership. The cash is used by the partnership to develop real property owned by the GOLF Partnership. Because the transfer is exempt under Internal Revenue Code section 721, the real estate excise tax does not apply to Mike's acquisition of a partnership interest in GOLF Partnership.

**(6) Rules of construction**. In determining whether a transfer qualifies for exemption under this section, the department will consider the law, regulations, bulletins, technical memoranda, letter rulings, etc., of the Internal Revenue Code and the Internal Revenue Service, as interpreted by the courts. Determinations of taxability under this chapter will be given the same treatment as the final determination of taxability for federal tax purposes.

| | |
|---|---|
| **From:** | David Green [david@davidgreencpa.com] |
| **Sent:** | Wednesday, December 14, 2011 1:52 PM |
| **To:** | |
| **Subject:** | FW: Washington Estate Tax Question |

David Green CPA/PFS, CFP®, AEP®
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For Internal Use
Client:
File: Correspondence,

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**From:** Kenall, Kari (DOR) [mailto:KariK@DOR.WA.GOV]
**Sent:** Wednesday, December 14, 2011 12:19 PM
**To:** David Green
**Subject:** RE: Washington Estate Tax Question

David,
Thank you for your recent inquiry. Real property and tangible personal property located outside WA at the time of death whether owned by the decedent or in a revocable trust can be apportioned as out of state property. All intangibles within the trust are allocated to the state of domicile. Please let me know if you have any additional questions.

Sincerely,
Kari Kenall

*Kari Kenall, Estate Tax Examiner*
Department of Revenue | Special Programs Division | PO Box 47488 | Olympia WA 98504-7488
ph: 360.570.5524
fax: 360.586.0796

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**From:** DOR Communications
**Sent:** Wednesday, December 14, 2011 12:08 PM
**To:** Kenall, Kari (DOR)
**Subject:** FW: Washington Estate Tax Question
**Importance:** High

State of Washington
Department of Revenue
Special Programs Divisions
PO Box 47488
Olympia, WA 98504-7488

# Washington State
# ,tate and Transfer Tax Return

For deaths occurring January 1, 2009 and after
when *not* filing Federal Form 706
(see separate instructions)

**Part 1 - Decedent and Executor (type or complete in ink)**

| 1. Decedent's first name and middle initial | 2. Decedent's last name | 3. Social Security Number |
|---|---|---|
| | | |

| 4. Legal residence (domicile) at time of death (county, state, and zip code, or foreign country) | 5. Year domicile established | 6. Date of birth | 7. Date of death |
|---|---|---|---|
| | | | |

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**REG / AR**
Index number

| 8. Name, address, and phone number of person required to file | 9. Name, address, and phone number of preparer (if applicable) |
|---|---|
| Telephone No: ______<br>Email Address: ______ | Telephone No: ______ Ext ______<br>Email Address: ______ |

| 10. Name and location of court where Will was probated or estate administered | 11. Cause number |
|---|---|
| | |

12. Check if applicable
- ☐ Decedent died testate
- ☐ Installment payment or filing election
- ☐ Nonresident return
- ☐ Extension form attached
- ☐ Amended return

RELEASE

I, ______ (Please Print), on behalf of the estate of ______ (Name of Decedent), authorize the Department of Revenue to release confidential estate tax information to ______ (Preparer). Preparer is authorized to discuss, and/or receive confidential estate tax information from the Department of Revenue.

**Part 2 - Tax Computation**

| | | | |
|---|---|---|---|
| A. | **Total Gross Estate Less Exclusion** (from page 3, Part 5, item 12) | A. | 4,000,000 0.00 |
| B. | **Total Allowable Deductions** (from page 3, Part 5, item 22) | B. | 0.00 |
| 1. | **Tentative Taxable Estate** (line A less line B) | 1. | 4,000,00 0.00 |
| 2. | **Adjustments to Tentative Taxable Estate** (total of lines 2a through 2c) | 2. | 0.00 |
| | QTIP under § 2056 — 2a. N/A | | |
| | § 2044 Property — 2b. ( ) | | |
| | 83.100.047 Property — 2c. | | |
| 3. | **Adjusted Taxable Estate** (total of lines 1 and 2) | 3. | 4,000,00 0.00 |
| 4. | **Washington State Deductions** (total of lines 4a through 4c) | 4. | 2,000,000 |
| | Statutory Deduction — 4a. 2,000,000.00 | | |
| | Farm Deduction — 4b. | | |
| | WA QTIP Deduction — 4c. Reflected on Sch M, item A | | |
| 5. | **Washington Taxable Estate** (line 3 less line 4) Do not enter less than "zero" | 5. | 2,000,00 0.00 |
| 6. | **Gross Washington Estate Tax** (Table W in instructions) Compute tax using the amount on line 5 | 6. | 140,000. |
| 7. | **Identify Out of State Property;** attach additional sheet if necessary (if no property, go to line 9) | | |

| Schedule/Item | Amount | Schedule/Item | Amount |
|---|---|---|---|
| 2,000,000 | | | |

| | | | |
|---|---|---|---|
| 8. | **Computation of Apportionment for Out of State Property:** | | |
| | 8a. Total value of Out of State Property listed in 7 above | 8a. | 2,000,000 |
| | 8b. Gross Estate (line A) | 8b. | 4,000,000 |
| | 8c. Adjusted Gross Estate (8b less 4b, less 2b, plus 2c) | 8c. | 4,000,000 |
| | 8d. Adjusted Gross Estate less Out of State Property (line 8c less 8a) | 8d. | 2,000,000 |
| | 8e. Washington Tax Due (line 8d divided by line 8c multiplied by line 6) | 8e. | 70,000 |
| 9. | **Washington Estate Tax Due** (equals line 6 or, if apportioning for Out of State Property, line 8e) | 9. | 70,00 0.00 |
| 10. | **Tax Previously Paid to Washington State** | 10. | |
| 11. | **Balance** | 11. | 0.00 |
| 12. | **Interest Due** (on any tax not paid within nine months after date of death) | 12. | |
| 13. | **Total Tax and Interest Due** (add lines 11 and 12) | 13. | 0.00 |
| 14. | **Total Amount Enclosed** | 14. | |

Under penalty of law, I declare that I have examined this return and, to the best of my knowledge and belief, it is true, correct, and complete.

______ (Signature of person required to file) ______ (Date)