

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u>
<u>N</u>	
For Ruling of Tax Liability of)	
)	No. 87-212
)	
)	Registration No. . . .
. . .)	
)	
)	
and)	
)	
. . .)	Unregistered

- [1] **RULE 106:** B&O TAX -- RETAIL SALES TAX -- CORPORATIONS -- TANGIBLE PERSONAL PROPERTY -- TRANSFER -- ADJUSTMENT OF BENEFICIAL INTEREST. Retail sales tax does not apply to transfers of corporate assets accomplished through an adjustment of beneficial interest because Rule 106 recognizes that a mere change in the form of ownership is not a "sale." Since such transfers are not sales, then neither are they subject to B&O tax.
- [2] **REAL ESTATE EXCISE TAX:** CORPORATION -- STOCK -- CONSIDERATION. A transfer of real property to a corporation in exchange for stock in the corporation is a taxable sale subject to the real estate excise tax (AGO 59-60 No. 100), but if no stock or other thing of value is given then the transfer is not taxable (AGO 63-64 No. 44, see also AGLO 1977 No. 6).
- [3] **RULE 106 AND RCW 82.04.040:** CORPORATIONS -- STOCK -- CONSIDERATION. A transfer of corporate assets to a stockholder in exchange for surrender of stock is not a "sale" for retail sales tax or use tax purposes.

[4] **RULE 106:** CORPORATIONS -- TRANSFERS -- STOCK -- CONSIDERATION -- STEP TRANSACTION -- KIMBELL-DIAMOND RULE. The Kimbell-Diamond Rule, which is applied in the field of federal income taxation, is not applicable for purposes of determining B&O, sales, or use tax liability. Compare Estep v. King City, 66 Wn.2d 76 (1965) holding the rule inapplicable to the real estate excise tax.

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.

NATURE OF ACTION:

Two taxpayers petition for a ruling of tax liability in respect to a proposed transaction in which the first taxpayer will transfer assets to a wholly-owned corporate subsidiary, and then sell the stock of the subsidiary to the second taxpayer who will dissolve the subsidiary and transfer the assets to itself in exchange for surrender of the stock.

FACTS:

Rosenbloom, A.L.J. -- The taxpayers' petition sets forth the following facts:

There are three corporations involved: . . . of America [Seller], a yet to be formed corporation (Z), and . . . [Buyer].

[Seller] is a validly incorporated [foreign] corporation, licensed and qualified to do business in the State of Washington.

[Buyer] is a validly incorporated [foreign] corporation, and will be licensed and qualified to do business in the State of Washington at the time of closing.

Z will be a corporation validly incorporated by [Seller in another state], licensed and qualified to do business in the State of Washington, to be formed prior to consummation of the proposed transactions with authorized but unissued capital of 1,000 shares of common stock.

[Seller] owns certain assets ("the assets") used in [its manufacturing] business . . . which it has conducted in the State of Washington for many years.

The assets consist of:

1. Real property.
2. Personal property including, but not limited to, inventory; plant equipment and other equipment used in the business; improvements, fixtures, easements and other uses; certain contracts and leases to which [Seller] is a party or successor in interest and other rights, licenses, and uses pertaining to the business; and certain books and records pertaining to the business.

The assets are subject to no liabilities nor will any liabilities be assumed by Z in the transactions.

[Seller] has previously paid all applicable Washington State taxes or use taxes on the personal property and excise tax on the real property.

No more than five (5) days prior to consummation of the transactions, [Seller] will cause Z to issue to [Seller] the 1,000 shares of common stock of Z in exchange for all of the personal property assets. The real property assets will be transferred to Z for no consideration at the same time the personal property assets are transferred. [Seller] will continue to hold other assets and remain in existence and in operation. The expected fair market value of all of the assets transferred to Z will be X dollars.

At closing, [Seller] shall deliver to [Buyer] the 1,000 shares of common stock of Z. In consideration thereof, [Buyer] shall pay to [Seller]:

1. Approximately .28X dollars in cash.
2. Approximately .72X dollars in a promissory note secured by inventory.

The total purchase price equals X dollars.

Immediately after consummation of the transactions set forth above, [Buyer] will cause its wholly-owned subsidiary Z to be merged into and with [Buyer]. Such merger will be accomplished by Z transferring all of its assets to [Buyer] for the surrender by [Buyer] of Z's capital stock.

RULING REQUESTED:

The taxpayers request a ruling that neither Seller, Z, nor Buyer will incur any retail sales tax, use tax, real estate excise tax, or business and occupation tax liability as a result of the proposed transactions. In particular, the taxpayers request rulings as follows:

As to the transfers from Seller to Z:

1. The retail sales tax will not apply to the contribution of the assets by Seller to Z.
2. The use tax will not apply to the contribution of the assets by Seller to Z.
3. The real estate excise tax will not apply to the contribution of the assets by Seller to Z, where this contribution is without consideration.
4. The business and occupation tax will not apply to the contribution of the assets by Seller to Z.

As to the sale of stock by Seller to Buyer:

5. The retail sales tax will not apply to the sale of stock of Z by Seller to Buyer.
6. The use tax will not apply to the sale of stock of Z by Seller to Buyer.
7. The real estate excise tax will not apply to the sale of stock of Z by Seller to Buyer.
8. The business and occupation tax will not apply to the sale of stock of Z by Seller to Buyer.

As to the merger of Buyer and Z:

9. The retail sales tax will not apply to the merger of Z into Buyer.

10. The use tax will not apply to the merger of Z into Buyer.

11. The real estate excise tax will not apply to the merger of Z into Buyer.

12. The business and occupation tax will not apply to the merger of Z into Buyer.

As to the transaction as a whole:

13. The retail sales tax will not apply to the transactions as a whole.

14. The use tax will not apply to the transactions as a whole.

15. The real estate excise tax will not apply to the transactions as a whole.

16. The business and occupation tax will not apply to the transactions as a whole.

DISCUSSION:

CONTRIBUTION OF ASSETS BY SELLER TO Z

The series of transactions proposed will result in no tax liability under the Washington Retail Sales Tax, Washington Use Tax, Washington Real Estate Excise Tax, or Washington Business and Occupation Tax. The reasoning for our conclusion is set forth below.

Retail Sales Tax (Ruling #1)

RCW 82.08.020 provides that "[t]here is levied and there shall be collected a tax on each retail sale in this state" (Emphasis added.)

WAC 458-20-106 provides that "[a] transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of beneficial interest of the business." The rule provides several examples of instances in which the tax will not apply, including the following:

1. "Transfers of capital assets between corporation and a wholly-owned subsidiary, or between wholly-owned subsidiaries of the same corporation."

2. "Transfers of capital assets . . . by a corporation to another corporation in exchange for the capital stock therein . . ."

In this portion of the transactions, Seller will be transferring capital assets between itself and its wholly-owned subsidiary, Z, within the meaning of WAC 458-20-106. (Example 1). Alternatively, Seller will be contributing capital assets solely in exchange for stock of Z, within the meaning of WAC 458-20-106. (Example 2). Therefore, the retail sales tax will not apply to the transfer from Seller to Z.

Use Tax (Ruling #2)

With regard to use tax, WAC 458-20-106 provides in part:

"Where there has been a transfer of the capital assets to or by a business, the use of such property is not deemed taxable to the extent the transfer was accomplished through an adjustment of beneficial interest in the business, provided, that transferor previously paid sales or use tax on the property transferred. (See the exempt situations listed under the retail sales tax subdivision of this rule)."

Both a transfer of capital assets between a corporation and its wholly-owned subsidiary and a transfer of capital assets by a corporation to another in exchange for capital stock therein are recognized in WAC 458-20-106 as examples of a transfer accomplished through an adjustment of beneficial interest in the business. (See WAC 458-20-106, Examples 1 and 2, cited earlier).

Therefore, the use tax will not apply to the transfer from Seller to Z as long as sales or use tax had been previously paid.

Business and Occupation Tax (Ruling #4)

[1] RCW 82.04.220 imposes a tax for the act or privilege of engaging in business activities. WAC 458-20-106 does not

address the application of business and occupation tax to transfers of capital assets to or by a business accomplished through an adjustment of the beneficial interest in the business. However, the non-taxable treatment explained under the heading Retail Sales Tax in WAC 458-20-106 results from the recognition that a mere change in the form of ownership of capital assets does not constitute a "sale" within the meaning of RCW 82.04.040. The purpose and intent of the rule is that retail sales tax shall not be imposed to impede or restrict business reorganizations where ownership of capital assets remains essentially the same and the change is one of form only.

Since both the business and occupation tax and the retail sales tax are triggered by the same event (a "sale" as defined by RCW 82.04.040), transfers accomplished through an adjustment of beneficial interest in the business must be accorded the same treatment for purposes of determining applicability of a business and occupation tax.

Therefore, no business and occupation tax liability will be incurred as a result of the proposed transfer of assets from Seller to Z.

Real Estate Excise Tax (Ruling #3)

[2] Generally, a transfer of real property to a corporation in exchange for stock in the corporation is a taxable sale subject to the real estate excise tax. AGO 59-60 No. 100.

WAC 458-61-320 provides in part:

The real estate excise tax applies to all real property transfers between a corporation and its . . . corporate affiliates . . ., except the following transfers which are not taxable:

(3) Transfers between a parent corporation and its wholly-owned subsidiary corporation or between two or more subsidiary corporations, each of which is wholly-owned by the same parent corporation where no consideration passes.

In AGO 63-64 No. 44, the taxpayer asked for a ruling as to the applicability of real estate excise tax where taxpayer proposed to transfer real property to a corporation where the transferor owned all the authorized issued and outstanding capital stock of the transferee and no additional stock was to

be issued in exchange for real property. The opinion stated that if no stock or other thing of value is given in exchange for the real estate, the transfer is not taxable. This opinion was confirmed by AGLO 1977 No. 6.

Therefore, in the fact situation set forth above where Seller transfers real property to Z and does not receive anything of value in return, such transfer will not be subject to real estate excise tax liability.

This analysis may appear inconsistent with the above discussion under the heading Retail Sales Tax and Business and Occupation Tax. However, there is a basis for treating the real estate excise tax differently. The taxable incident in the case of the retail sales tax and the business and occupation tax is a "sale" as defined at RCW 82.04.040. The taxable event for purposes of the real estate excise tax is a "sale" as defined at RCW 82.45.010.

SALE OF STOCK OF Z BY SELLER TO BUYER

Retail Sales Tax (Ruling #5)

RCW 82.04.050 defines retail sale as "every sale of tangible personal property . . ." The stock of Z is not "tangible personal property." It is instead intangible property. Because the retail sales tax applies only to the sale of tangible personal property and not intangible property, the retail sales tax does not apply to the sale of stock of Z by Seller to Buyer.

Use Tax (Ruling #6)

Again, the use tax applies only to the use of "tangible personal property." Stock is intangible property, and therefore, there is no use tax on the transfer of stock of Z from Seller to Buyer.

Real Estate Excise Tax (Ruling #7)

A real estate excise tax is imposed upon the sale of real property under RCW 82.45.010. Such tax does not apply to sales of stock because there is no "conveyance, grant, assignment, quitclaim or transfer of the ownership of or title to real property" which the definition of "sale" in RCW 82.45.010.

Therefore, the real estate excise tax does not apply to the sale of stock of Z by Seller to Buyer.

Business and Occupation Tax (Ruling #8)

WAC 458-20-106 provides that casual and isolated sales are excepted from the business and occupation tax. Seller does not engage in the business of selling stock. Therefore, the sale of Z stock by Seller to Buyer is not subject to the business and occupation tax.

MERGER OF Z INTO BUYER

Retail Sales Tax (Ruling #9)

WAC 458-20-106 provides that a "transfer of capital assets to or by a business is deemed not taxable to the extent that the transfer is accomplished through an adjustment of the beneficial interest in the business." The rule provides several examples of such transfers, including the following:

"Transfers of capital assets by a corporation to its stockholders in exchange for surrender of capital stock."

This is precisely the manner in which the taxpayer proposes to transfer the assets from A to Buyer. Accordingly, no retail sales tax liability will be incurred as a result of transfer of the assets from Z to Buyer in exchange for surrender of the stock of Z.

Use Tax (Ruling #10)

Use tax applies upon the use of tangible personal property "purchased at retail, or acquired by lease, gift, repossession or bailment, or extracted or produced by the person so using the same, or otherwise furnished to a person engaged in any business taxable under RCW 82.04.280(2) or (7)." Under the proposed transaction, Buyer will not acquire the assets by lease, gift or any of the manners of acquisition enumerated thereafter. The only question is whether the assets will be purchased at retail. A purchase occurs only if there is a "sale" which is defined as "any transfer of ownership of, title to, or possession of property for a valuable consideration." RCW 82.04.040. (This definition applies equally in the context of the use tax, see RCW 82.12.010(5).)

[3] In Weaver v. King County, 73 Wn.2d 183, 184 (1968), the Washington Supreme Court stated that:

The right of a stockholder to receive corporate assets in kind in the voluntary dissolution of a solvent corporation is an incident to corporate stock ownership, the right following ownership of the stock. The conveyance of corporate real property as a liquidating dividend to a distributee-stockholder by the liquidating trustee of a solvent corporation in a dissolution is not a "conveyance, grant . . . or transfer . . . for valuable consideration . . ." or a "sale" in the ordinary sense . . .

(Citing Deer Park Pine Industries, Inc. v. Stevens Co., 46 Wn.2d 852 (1955).)

The court in Weaver was construing "sale" as defined in RCW 82.45.010 for purposes of the real estate excise tax. However, it should be noted that the language in that statute is very similar to the definition of "sale" provided in RCW 82.04.040.

Furthermore, it has already been noted that the RCW 82.04.040 definition of "sale" is interpreted more narrowly than the one provided in RCW 82.45.010. Thus, a transfer of tangible personal property to a corporation in exchange for stock therein is not subject to retail sales tax, WAC 458-20-106, whereas a transfer of real property to a corporation in exchange for stock therein is a taxable sale for purposes of the real estate excise tax. AGO 59-60 No. 100, see also AGLO 1977 No. 6.

It would defy logic to say that the opposite is true in the case of a corporate dissolution, i.e., that a transfer of corporate assets to a stockholder in exchange for surrender of stock is a sale for retail sales tax or use tax purposes, even though such a transfer is not a sale for real estate excise tax purposes.

Following the above logic, there is no "sale" of the assets from Z to Buyer. The assets will not be "purchased at retail." Nor will they be acquired in any of the other manners enumerated in the statute. Therefore use tax will not apply upon Buyer's use of assets transferred by Z to Buyer in exchange for the surrender of the stock of Z.

Business and Occupation Tax (Ruling #12)

As noted under the preceding heading, there is no "sale" within the meaning of RCW 82.04.040 upon the distribution of capital assets by a solvent corporation in voluntary dissolution to its shareholders in exchange for the surrender of stock in the corporation.

Accordingly, there is no taxable incident upon which the business and occupation tax can apply in this transaction.

Real Estate Excise Tax (Ruling #11)

Weaver v. King County, *supra*, is controlling as to the issue of whether real estate excise tax will apply in the merger of Z and Buyer, i.e., there is no sale for real estate excise tax purposes.

Additionally, WAC 458-61-320 provides that:

The real estate excise tax applies to all real property transfers between a corporation and its stockholders, officers, corporate affiliates, or other parties, corporations and partnerships except the following transfers which are not taxable:

(1) corporate mergers and consolidation which are accomplished by stock transfers.

Therefore, according to both the Weaver holding and the applicable WAC, real estate excise tax will not apply upon the transfer of real property from Z to Buyer in exchange for surrender of the stock of Z.

TRANSACTION AS A WHOLE

(Rulings #13, 14, 15 and 16)

[4] In Estep, 66 Wn.2d 76, the defendant, King County "assigned error to the court's failure to recognize and consider two instruments as one transaction" The defendants asserted that although the real estate excise tax does not apply to each transaction separately, Deer Park, 46 Wn.2d 852, as one package the transactions should constitute a sale. The Washington State Supreme Court specifically ruled

that the Kimbell-Diamond Rule¹ is inapplicable to the real estate excise tax statute.

In Estep, the court stated:

Adoption of the rule would write into Washington law a provision not voiced by the Legislature and would make suspect every conveyance of real property by a corporate liquidating trustee. It would involve the county and the courts in a search for subjective intents, motives and purposes every time a transfer of stock is followed by a transfer of real property in corporate dissolution. Any change in the application of the statutes and ordinance must be legislative.

We think this reasoning applies equally in the context of the retail sales tax, use tax, and B&O tax.

Since, for the reasons discussed above, neither the retail sales tax, the use tax, the real estate excise tax, nor the business and occupation tax would apply to any of the transactions, none of the taxes should apply to the transactions as a whole.

This legal opinion maybe relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the taxpayer. In this regard, the Department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind this taxpayer and the Department upon these facts. However, it shall not be binding if there are relevant facts which are in existence but have

¹ The Kimbell-Diamond Rule is explained in United States v. Mattison, 273 F.2d 13 (9th Cir. 1959), as follows:

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

not been disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently changes and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 19th day of June 1987.