

Cite as Det. No. 16-0174, 35 WTD 624 (2016)

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

In the Matter of the Petition for Correction of ) D E T E R M I N A T I O N  
Assessment of ) No. 16-0174  
 )  
 )  
... ) Registration No. . . .  
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[1] RCW 82.45.010; WAC 458-61A-102; WAC 458-61A-103: REAL ESTATE EXCISE TAX – TRANSFER OF PROPERTY FOR VALUABLE CONSIDERATION – RELIEF FROM UNDERLYING DEBT. A grantor is liable for real estate excise tax when it transfers the property to a grantee in exchange for relief of underlying debt for which the grantor has personal liability.

[2] WAC 458-61A-103: REAL ESTATE EXCISE TAX – PERSONAL LIABILITY FOR UNDERLYING DEBT. A property owner has personal liability for an underlying debt on the property when the terms of the note allow the note holder to recover monetary damages beyond foreclosure of the property in the event of default.

[3] RCW 82.45.100; RCW 82.32.105; WAC 458-61A-306; WAC 458-20-228: PENALTIES AND INTEREST – WAIVER OR CANCELLATION. The Department has no authority to waive penalties and interest based on a taxpayer's good faith belief that they qualified for an exemption from 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.

Poley, T.R.O. – A married couple protests the assessment of real estate excise tax [REET] on the transfer of real property to the parents of one of the spouses in exchange for forgiveness of a loan. We conclude that the forgiveness of a loan is consideration and the transfer constitutes a sale for [REET] purposes. The assessment is affirmed.<sup>1</sup>

## ISSUES

1. Was a transfer of real property in exchange for relief from a debt a “sale” for purposes of [REET] under RCW 82.45.010, WAC 458-61A-102, and WAC 458-61A-103?

<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Is a grantor of real property eligible for a waiver of penalties and interest under RCW 82.45.100 and WAC 458-61A-306?

#### FINDINGS OF FACT

In 2010, [Parents] loaned money to their daughter and son-in-law [Taxpayers] in order for Taxpayers to purchase a house in . . . , Washington. Taxpayers acted as landlords and rented the house to tenants. Taxpayers later decided they no longer wished to own the rental property or be responsible for its upkeep.

On December 27, 2012, Taxpayers agreed to transfer the property via quit-claim deed to Parents in lieu of repaying the loan. At the time of the transfer, Taxpayers owed Parents \$ . . . . Taxpayers filed an affidavit (Affidavit) as required by the Department of Revenue (Department) and listed the amount of the loan balance as the “gross selling price” of the property. Taxpayers also asserted on the Affidavit that the transfer was exempt from [REET], stating, “Real estate excise tax does not apply to this transfer of real property because it is subject to an underlying debt for which the grantor has no personal liability per unrecorded promissory note and accompanying security agreement, and receives no other consideration.”

In 2015, the Department’s Special Programs Division began an audit related to the exemption claimed in the Affidavit. Parents responded, claiming that the debt owed to them by Taxpayers was non-recourse debt, and as family members, Parents never intended for Taxpayers to incur any loss beyond surrender of the residence.

Parents provided the Department with a copy of a promissory note (Note) and security agreement (Security). Both the Note and the Security were signed by Taxpayers and dated May 18, 2010. Neither were publicly recorded. The Note stated that Taxpayers were “jointly and severally liable for any debts secured by this Note.” The Note also contained a provision addressing default:

In the event of default, the Borrowers agree to pay all costs and expenses incurred by the Lenders, including all reasonable attorney fees (including both hourly and contingency attorney fees as permitted by law) for the collection of this Note upon default, and including reasonable collection charges (including, where consistent with industry practices, a collection charge set as a percentage of the outstanding balance of this Note) should collection be referred to a collection agency.

The Security states that Taxpayers grant a security interest in the residence to Parents in consideration of the Note. If Taxpayers default on the Note, Parents have the right to take possession of the residence, sell it “in any manner which they may deem fit,” and apply the proceeds from the sale to the loan described in the Note. Paragraph ten of the Security affirms that Taxpayers “agree that they shall remain liable for any shortfall if the proceeds from the sale of the Collateral are not sufficient to repay all monies due under the Note.”

After completing their investigation, the Department determined that Taxpayers owed REET on the transfer of the residence to Parents. The Department issued a REET adjusted assessment on

January 28, 2016, for \$ . . . , which included \$ . . . in tax, \$ . . . assessment penalty, and \$ . . . in interest. Taxpayer timely requested administrative review.

At the hearing, Parents stated that the property transfer was neither a gift nor an attempt to avoid foreclosure as Taxpayers were still able to pay the Note. Rather, Parents asserted they acquired ownership of the property because Taxpayers no longer desired to own it and an adverse housing market deterred Taxpayers from selling to a third party. Taxpayers and Parents claim the debt underlying the property was non-recourse and thus REET does not apply to the transfer. In the alternative, if their petition is denied, Taxpayers request a waiver of penalties and interest as they acted in good faith when claiming the exemption from REET.

## ANALYSIS

REET is imposed on each sale of real property located within Washington based on a percentage of the “selling price.” RCW 82.45.060. RCW 82.45.010(1) defines “sale” to include: “any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property . . . for a valuable consideration.” For purposes of REET, the term “total consideration paid” includes:

[M]oney or anything of value, paid or delivered or contracted to be paid or delivered in return for the sale, and shall include the amount of any lien, mortgage, contract indebtedness, or other incumbrance, either given to secure the purchase price, or any part thereof, or remaining unpaid on such property at the time of sale.

RCW 82.45.030(3); *see also* WAC 458-61A-102(19).

Generally, REET applies to a transfer of ownership of real property when the grantee relieves the grantor from an underlying debt on the property. WAC 458-61A-103(1). However, REET 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. WAC 458-61A-103(2). Here, the Note and Security, by their own terms, hold Taxpayers personally liable for the debt in the Note. Accordingly, the exemption from REET under WAC 458-61A-103(2) is not applicable to this case.

It is irrelevant that Parents never recorded the Note and Security, as doing so would only perfect their interests against other lien holders. It is also irrelevant whether Parents ever planned to enforce the Note and Security; WAC 458-61A-103(2) only concerns whether Parents had the ability to do so. Taxpayer’s personal liability for the Note was only relieved when Taxpayers transferred title to the property to Parents. Therefore, pursuant to WAC 458-61A-103(1), Taxpayers’ transfer of title to the property to Parents in exchange for relief from the remaining \$ . . . owed on the Note is a “sale” subject to REET.

Taxpayers next ask us to waive penalties and interest in this case because they acted in good faith when claiming the exemption from REET. Taxpayers have certain rights and responsibilities under the law, including the responsibility to pay taxes in a timely manner. RCW 82.32A.030.

A seller of real property bears the obligation to pay REET. RCW 82.45.080(1). REET is due immediately at the time of sale. RCW 82.45.100(1); WAC 458-61A-101(9). If REET is not paid within one month of the date of sale, interest will accrue from the date of sale until the date of full payment. *Id.*; see also WAC 458-61A-306(3).

The Department operates under a progressive delinquent penalty scheme, outlined in RCW 82.45.100(2):

In addition to the interest described in subsection (1) of this section, if the payment of any tax is not received by the county treasurer or the department of revenue, as the case may be, within one month of the date due, there is assessed a penalty of five percent of the amount of the tax; if the tax is not received within two months of the date due, there will be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within three months of the date due, there will be assessed a total penalty of twenty percent of the amount of the tax.

*See also* WAC 458-61A-306(4).

If the Department discovers that a taxpayer has failed to properly pay REET when due, it must assess against the taxpayer the amount due and include interest and the appropriate delinquent penalty. RCW 82.45.100(4). The Department is also required to assess a five percent assessment penalty if the seller has “substantially underpaid” the amount of REET due. RCW 82.32.090(2);<sup>2</sup> WAC 458-61A-306(4). “Substantially underpaid” under RCW 82.32.090(2) “means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due . . . and the amount of underpayment is at least one thousand dollars.”

The Department must impose interest and penalties when the conditions for imposing them are met. RCW 82.32.090(1); Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001).

Here, the Department correctly assessed the unpaid REET and included interest calculated from the date of the sale. The Department assessed a 20 percent delinquent penalty for failure to pay REET within three months of the date of sale pursuant to RCW 82.45.100(2) and added a five percent assessment penalty for substantial underpayment of REET pursuant to RCW 82.32.090(2).

Having determined that the Department properly imposed the assessed penalties and interest, we now turn to whether the Department can waive them.

The Department has limited authority to waive or cancel penalties. RCW 82.32.105. The Department can cancel penalties only when the penalties were the result of “circumstances beyond the control of the taxpayer.” RCW 82.32.105(1).

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<sup>2</sup> As explained in RCW 82.45.150, all of chapter 82.32. RCW applies to chapter 82.45. RCW, except for certain statutory provisions. While RCW 82.32.090(1) is one of these exceptions, RCW 82.32.090(2) is not and the substantial underpayment penalty applies to REET assessments.

WAC 458-20-228 explains that “[c]ircumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay.” WAC 458-20-228(9)(a)(ii). The circumstances must directly cause the late payment or substantial underpayment. WAC 458-20-228(9)(a)(i).

WAC 458-20-228(9)(a)(ii) lists examples of circumstances that are beyond a taxpayer’s control sufficient to cancel penalties:

- Erroneous written information from the Department
- An act of fraud or conversion by the taxpayer’s employee or contract helper which the taxpayer could not immediately detect or prevent
- Emergency circumstances around the time of the due date, such as the death or serious illness of the taxpayer or a family member or accountant

WAC 458-20-228(9)(a)(iii) also lists examples of situations that are generally *not* beyond the control of a taxpayer:

- Financial hardship
- A misunderstanding or lack of knowledge of a tax liability
- Mistakes or misconduct on the part of employees or other persons contracted with the taxpayer

In Det. No. 01-165R, 22 WTD 11 (2003), we reiterated that lack of knowledge of a tax liability was not grounds the Department could consider for waiving the penalty imposed in that case. Because of the nature of Washington’s tax system, the burden of becoming informed about tax liability falls upon the taxpayer, and it is the taxpayer who bears the consequences of a failure to be correctly informed. *Id.* at 15.

Here, Taxpayers have not established that they are eligible for waiver of either penalty. Taxpayers failed to pay REET at the time of the sale because they thought the transaction was exempt from REET; this is not an immediate, unexpected emergency. A misunderstanding or lack of knowledge of a tax liability is specifically listed as an example of a situation that is not beyond a taxpayer’s control. Taxpayers’ good faith belief that they qualified for the exemption from REET cannot overcome the Department’s statutory obligations to impose penalties when the conditions for imposing them are met. Accordingly, we cannot waive the assessed penalties as there were no circumstances beyond Taxpayer’s control.

Finally, RCW 82.32.105(3) provides the two circumstances under which the Department will waive or cancel interest:

- (a) The failure to timely pay the tax was the direct result of written instructions given the taxpayer by the department; or

- (b) The extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department.

Taxpayer has not alleged that it acted pursuant to written instructions from the Department and there is no evidence of such action occurring. There is also no indication that the due date for the assessment was extended at the Department's request. As neither circumstance under RCW 82.32.105(3) is present in this case, Taxpayer is not eligible for waiver of interest.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 11th day of May, 2016.