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The Real Estate Excise Tax Controlling Interest Transfer 36-Month Lookback Period

Purpose

This ETA explains changes to the Real Estate Excise Tax (REET) resulting from 2019 legislation, [ESSB 5998](#). REET applies to transfers of controlling interests in real property-holding entities. The legislation extends the “lookback” period for determining whether a controlling interest transfer has occurred, and this ETA addresses how to apply the lookback period in the transition from a 12-month lookback to a 36-month lookback.

ESSB 5998 and the 2019 legislative changes

In general, transfers of controlling interests in entities that hold real estate are subject to REET. In 2019, the Legislature expanded the transactions to which REET applies. From July 1, 1993, through December 31, 2019, REET applied to a transfer of a controlling interest in an entity, determined by taking into account all transactions within a 12-month period. The new legislation, effective January 1, 2020, extends this “lookback” period from 12 months to 36 months.

What is a controlling interest?

For profit corporations, a “controlling interest” means either 50% or more of the total combined voting power of all classes of stock entitled to vote, or 50% of the capital, profits, or beneficial interest in the voting stock of the corporation. For other corporations, partnerships, LLCs, associations, trusts, or other entities, “controlling interest” means 50% or more of the capital, profits, or beneficial interest in the entity. RCW 82.45.033 and WAC 458-61A-102(3).

When a controlling interest in an entity holding real property is transferred, REET applies to the value of all real property owned by the business entity. RCW 82.45.010(2) and RCW 82.45.030(2).

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**What is the
“lookback” period?**

Controlling interest transfers can occur over time, and in stages through multiple sales. The date of sale for REET assessment purposes, is the date the buyer reaches a 50% or more interest.¹ The buyer of a controlling interest can purchase their 50% or greater share all at once, either from one seller, or several.² The “lookback” period, also referred to as the “taxable transfer period” in WAC 458-61A-101, is the timeframe over which multiple purchases are combined to determine whether a controlling interest has been transferred. Non-controlling interest transfers are aggregated in the lookback period to determine if the 50% threshold is reached. While the tax does not arise until the 50% level is reached, each interest in the entity sold during the lookback period is subject to a proportionate share of the total tax resulting from the controlling interest transfer.

**How does the new
36-month lookback
period work?**

Transactions occurring prior to January 1, 2019, are not included in determining of whether a transfer of a controlling interest occurred within a 36-month period. Only transactions occurring on January 1, 2019, or later, are included to determine whether a transfer or acquisition of a controlling interest occurred within the 36-month lookback period.

Through December 31, 2019, the 12-month lookback period remains in effect. For example, the REET applies if a buyer purchases a 10% interest on September 21, 2019, and had purchased a 40% interest on October 2, 2018 because there has been a controlling interest transfer in the 12-month period from January 1, 2019 through December 31, 2019.

Examples

The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

Example 1:

Facts:

- King Towers Inc. is a corporation that owns an apartment building in Seattle.
- On November 7, 2018, Leonard Takai purchases 10% of King Towers outstanding stock from shareholder #1.
- On July 17, 2019, Mr. Takai purchases another 20% of the stock from shareholder #2.
- Finally, on February 2, 2020, he purchases another 20% from shareholder #3.
- There were no other sales of King Towers stock during this period.

¹ If a buyer enters into an agreement to acquire a controlling interest through a series of purchases over time, the agreement date is the date of sale. WAC 458-61A-101(6).

² Controlling interests transfers can occur through acquisitions of interests by more than one buyer, if the buyers are acting in concert. WAC 458-61A-101(5).

Result:

- As of February 2, 2020, Mr. Takai has a controlling interest in King Towers Inc. His three stock purchases total 50% of the corporation.
- While Mr. Takai now owns a controlling interest in King Towers Inc., he did not acquire that controlling interest in any one applicable lookback period.
 - Mr. Takai did not acquire at least 50% of King Towers during any 12-month period prior to January 1, 2020.
 - Further, because Mr. Takai's first stock purchase was made prior to January 1, 2019, his 10% purchase in 2018 is not considered part of the 36-month lookback period enacted by ESSB 5998 and effective starting on January 1, 2020. Thus, from January 1, 2019 through February 2, 2020 Mr. Takai is considered only to have purchased a 40% interest for purposes of the REET.
- Consequently, the REET does not apply.

Example 2:

Facts:

- Atlas Vintner Partners (Atlas) owns 100 acres of grape-producing farmland in Yakima.
- Nichelle Kelly purchases partner #1's 20% share in Atlas on October 6, 2019.
- She purchases partner #2's 20% share Atlas on June 3, 2020.
- Lastly, she purchases partner #3's 15% share in Atlas on September 28, 2022.

Result:

- As of September 28, 2022, Ms. Kelly has a 55% controlling interest in Atlas.
- All of her purchases of Atlas shares occurred within the 36 months prior to September 28, 2022.
- Accordingly, the REET applies and each of the three partners who sold shares to Ms. Kelly will owe their proportionate share of the REET as of September 28, 2022.

REET calculation

WAC 458-20-101(6)(d)(ii) provides an example of how REET is calculated in the case of a controlling interest transfer occurring through multiple purchases over a period of time.

(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%.

The manner in which the REET is calculated in the above example remains unchanged by ESSB 5998. However, the timeframe in which the multiple purchases can be considered in determining whether a controlling interest has been transferred is extended from 12 to 36 months.

Who owes the REET? Normally, REET is imposed on sellers. However, in the case of controlling interest transfers, the Department may enforce the REET against the purchaser or the business entity owning the real property. If unpaid, the REET is a lien against the real property owned by the business entity in which the controlling interest was transferred.

Reporting controlling interests Businesses filing annual reports with the Secretary of State's office that own an interest in real property located in Washington must disclose controlling interest transfers. Through December 31, 2019, a controlling interest transfer occurring during the reporting period must be listed on the annual report. Starting January 1, 2020, a business must report transfers of a $1/6^{\text{th}}$ (one-sixth) or more interest in the business on its annual report.

Related information The Department of Revenue has additional information on the REET, including the graduated REET rates going into effect January 1, 2020. See: <https://dor.wa.gov/find-taxes-rates/other-taxes/real-estate-excise-tax>
