

# HOUSE BILL REPORT

## HB 1664

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### As Reported By House Committee On:

Finance

**Title:** An act relating to preventing the use of step transactions to avoid real estate excise tax.

**Brief Description:** Preventing the use of step transactions to avoid real estate excise tax.

**Sponsors:** Representatives Dickerson, Thomas and Dunshee; by request of Department of Revenue.

### Brief History:

#### Committee Activity:

Finance: 2/16/99, 3/8/99 [DP].

#### Brief Summary of Bill

- Applies real estate excise tax to certain "step transactions" involving formation, liquidation, dissolution, or reorganization of a partnership or corporation that owns real estate.
- Tax applies if a series of transactions transfers control of the partnership or corporation within a 12-month period.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 12 members: Representatives Dunshee, Democratic Co-Chair; Thomas, Republican Co-Chair; Carrell, Republican Vice Chair; Reardon, Democratic Vice Chair; Cairnes; Conway; Cox; Dickerson; Pennington; Santos; Van Luven and Veloria.

**Staff:** Bob Longman (786-7139).

### Background:

The real estate excise tax (REET) is imposed on each sale of real property. The state tax rate is 1.28 percent. Additional local rates are allowed. Cities and counties may

impose an additional 0.25 percent rate for capital improvements. Cities and counties may also impose a second 0.25 percent rate for capital projects specified in a city or county's comprehensive plan. An additional rate of 0.5 percent is available for cities and counties not imposing the second 0.5 percent of the local sales tax. A county may impose an additional 1 percent rate for acquisition and maintenance of conservation areas if this rate is approved by voters.

The tax is applied when a sale occurs. A sale is defined as any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property.

A seller pays real estate excise taxes. The only exception is the 1 percent county conservation rate which is paid by buyers.

Before 1991, a sale of a controlling interest in a partnership or corporation could effectively transfer control of real estate owned by the partnership or corporation without creating REET liability. Legislation was enacted in 1991 and substantially amended in 1993 to apply REET to the value of real estate owned by a partnership or corporation upon transfer of a controlling interest in the partnership or corporation. However, REET does not apply to real property transfers resulting from the formation, liquidation, dissolution, or reorganization of entities if the transactions do not result in federal income tax liability.

It is possible to transfer effective control of real estate without REET liability using a "step transaction." A buyer can contribute capital to a corporation or partnership to dilute the current owner's interest to less than 50 percent. The buyer can then purchase the minority interest and liquidate the business. Since real property transfers involving formation, liquidation, dissolution, or reorganization of entities are not subject to the real estate excise tax, the result is the transfer of real property without payment of the tax.

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### **Summary of Bill:**

The exemption from the real estate excise tax for real property transfers involving the formation, liquidation, dissolution, or reorganization of partnerships and corporations is narrowed. Under this narrower exemption, tax applies if all of the following conditions are met:

- (1) There is more than one of these formation, liquidation, dissolution, or reorganization transactions within a 12-month period;
- (2) The result is the transfer of a controlling interest in any entity with an interest in real property in this state; and

- (3) One or more persons previously holding a controlling interest in the entity receive cash or property for the interest.

When these conditions are met, real estate excise tax is due from the person who previously held the controlling interest in the entity.

However, tax does not apply to a person who receives real property that the person originally contributed to the entity, a person who did not contribute real property to the entity, or a person that did not have an interest in the entity when real property was purchased.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** Step transactions have been used for the sole purpose of avoiding tax. This bill does not increase a tax, it just closes a loophole.

**Testimony Against:** None.

**Testified:** Representative Dickerson, prime sponsor; and Leslie Cushman, Department of Revenue.