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In this article, Willens criticizes two decisions by the Wisconsin Tax Appeals Commission regarding real estate transfer fees.

In the space of just one short week, the Wisconsin Tax Appeals Commission (WTAC) rendered two decisions that appear incorrect as a matter of law and, accordingly, upheld the imposition of real estate transfer fees that should not have been levied. While at this point we have become somewhat inured to seeing questionable jurisprudence in the real estate transfer tax or fee area, these two decisions — at least to this observer — stand out as particularly egregious.

'Cause to Be Directed'

In *North Mayfair Road*,[1] on or about December 31, 2014, a real estate transfer return was filed reporting a conveyance of real estate from Mayfair Road LP (WILC) to the grantee, MSC, via special warranty deed. The return indicated a transfer fee due of $0 by claiming a transfer fee exemption. The Wisconsin Department of Revenue disagreed with the claim that no transfer fee was due and issued a notice of assessment of real estate transfer fee of $32,205. While the petitioner timely appealed the assessment, the appeal was to no avail because the DOR summarily denied the petition. An appeal before the WTAC followed.

The petitioner was a Wisconsin limited partnership that had fallen on hard times. In May 2014 Wells Fargo filed a summons and complaint against WILC seeking foreclosure of the property. In December 2014 a judgment of foreclosure was entered against WILC and in favor of Wells Fargo. WILC and Wells Fargo entered into a deed in lieu of foreclosure agreement (the agreement). In December 2014, in accordance with the agreement, WILC executed a special warranty deed to MSC, a newly created single member limited liability company of which Wells Fargo was the sole member. The mortgage that was the subject of the foreclosure was not assigned to MSC. Instead, Wells Fargo continued to hold the mortgage and a satisfaction of the mortgage was duly recorded. It is important to note that while the property "came to rest" in MSC, the agreement was entered into by WILC and Wells Fargo. MSC was not a party to the agreement. Not surprisingly, lenders such as Wells Fargo commonly form special purpose subsidiary entities to acquire and hold title to properties conveyed by means of a deed in lieu of foreclosure.

Wis. Stat. section 77.22 provides that "there is hereby imposed on the grantor of real estate a real estate transfer fee" on every conveyance neither exempted nor excluded. One of those exemptions, found in Wis. Stat. section 77.25, provides that the fee does not apply to a conveyance under a foreclosure or deed in lieu of foreclosure "to a person holding the mortgage."

Tax exemptions, deductions, and privileges, the WTAC correctly observed, are matters of

[1] *North Mayfair Road LP v. Wisconsin Department of Revenue*, Dkt No. 17-T-154 (Wisc. Tax App. Comm. Jan. 28, 2020).

legislative grace "and are strictly construed against the aggrieved taxpayer." While the WTAC admitted that a fee is not a "tax," it has "similar characteristics." Accordingly, exemptions from this fee ought to be similarly narrowly construed against the claimant.

Under the Wisconsin real estate transfer fee statutes, "a deed in lieu of foreclosure to the person holding the mortgage" is exempt from the fee. Here, the parties stipulated that (1) Wells Fargo held the mortgage at all times; (2) Wells Fargo did not assign, nor otherwise transfer, the mortgage to MSC; and (3) while MSC is a single member LLC, of which Wells Fargo happened to be the sole member, MSC is a separate entity from Wells Fargo. According to the terms of the agreement, WILC was required to transfer the property at Wells Fargo's direction not to the mortgage holder, Wells Fargo, but to a separate entity, MSC. Wells Fargo remained the mortgage holder at the time of the conveyance; it follows that MSC was decidedly not "the person holding the mortgage."

WILC made several arguments but did not make the "correct" argument. WILC's primary contention — unsurprisingly, given that MSC was a disregarded entity for tax purposes — was that Wells Fargo and MSC were "one and the same." WILC pointed out that in the real estate field, lenders such as Wells Fargo rarely, if ever, take title to repossessed property in their own names. Instead, they typically create new entities to hold title because they are separate entities. These separate entities, including MSC, hold real estate "because an entity formed for the exclusive purpose of holding title" to foreclosed property "shields the lender from liability." Thus, the WTAC observed, "the nature of the subsidiary as being separate and distinct from the lender is paramount." Entities such as MSC, designed to hold title, must be completely different entities from the lender, rather than one and the same. Thus, the WTAC found that Wells Fargo is separate and distinct from MSC. Property owned by an LLC, the WTAC ruled, is not owned by its members. Wells Fargo held the mortgage and MSC did not, the WTAC noted. WILC conveyed (at Wells Fargo's direction) the property to MSC. MSC is not Wells Fargo, and the converse is also true. Thus, the transfer from WILC not to the mortgage holder but to the mortgage holder's subsidiary does not qualify for the transfer fee exemption. WILC also asserted, futilely, that MSC acted as Wells Fargo's agent in receiving the property and that the mortgage holder, Wells Fargo, therefore took constructive title to the property. That argument, the WTAC pointed out, "is inconsistent with [WILC's] earlier explanation of the 'industry practice' of establishing separate entities to hold title as a shield against liability." The agency claim was rejected as both "unsupported and underdeveloped." The exemption, therefore, in the final analysis does not apply. The DOR's motion for summary judgment was granted.

Three-party transactions, of the type at issue here, are known as "cause to be directed" transactions, in which the transferee of the property conveyed by the transferor is the party at whose direction the property was transferred.

In Rev. Rul. 70-224, 1970-1 C.B. 79, X Corp. owned all the stock of Y Corp. X proposed to acquire all the properties of unrelated Z Corp. X and Z entered into a plan of reorganization and agreement that provided that X would acquire all the properties of Z solely in exchange for voting stock of X, and X would assume the liabilities of Z. Under the plan, X caused the assets of Z to be transferred directly to Y. X issued its voting stock to Z and assumed the liabilities of Z. It was imperative that X be seen as the acquiring corporation in this transaction. If X was not the acquiring corporation, its assumption of Z's liabilities would be considered "other property or money," with the result that the transaction would not satisfy the "solely for voting stock" requirement necessary for a transaction to qualify as a reorganization under IRC section 368(a)(1)(C).[2]

The IRS reached the desired conclusion. The transaction, it concluded, "is an acquisition by X, solely in exchange for its voting stock and the assumption of Z's liabilities, of substantially all of the properties of Z, and is, therefore, a reorganization within the meaning of section 368(a)(1)(C) of the Code." The fact that Z's assets were transferred directly to Y, rather than through

[2] *See* Rev. Rul. 70-107, 1970-1 C.B. 70.

X to Y, does not affect the reorganization. Why not? Because the plan of reorganization and agreement between X and Z explicitly provided that X would acquire the properties of Z in consideration of X's stock and the assumption by X of Z's liabilities. When the reorganization became effective, X, at all times, had dominion and control of the Z assets, and X is therefore regarded as having received Z's assets and transferred them to Y.

In the instant case, the parties to the agreement were WILC and Wells Fargo. Under the agreement, WILC was directed to transfer the property directly to MSC. Nevertheless, here, as in Rev. Rul. 70-224, the plan provided that Wells Fargo would acquire the property such that when the agreement became effective, Wells Fargo at all times "had dominion and control of the Property" and should therefore be regarded as having received the property and then as having conveyed the property to MSC. In short, by the terms of the agreement, the property was a conveyance "under a foreclosure or a deed in lieu of foreclosure to a person, [Wells Fargo], holding a mortgage." Accordingly, the transaction appears to be fully eligible for the Wisc. Stat. section 77.25 exemption to the real estate transfer fee tariff. WILC did enough to avail itself of the exemption since it conveyed the property under a foreclosure or deed in lieu of foreclosure to the very person, Wells Fargo, who held the mortgage. The fact that Wells Fargo then transferred the property to its controlled subsidiary, MSC, is of no moment, even though a retransfer was obviously contemplated from the outset. All that matters is that the transferee of the property be the same party who holds the mortgage — and here, the transferee, after its proper identification under cause to be directed principles, was that party. We would like nothing more than to see WILC appeal the WTAC's decision and use, we believe persuasively, the cause to be directed argument in making its appellate case.

Liquidation-Reincorporation

In *Doneff*,[3] Southbrook LLP filed in January 2016 an electronic real estate transfer return, reporting the December 2015 conveyance of real estate, valued at more than $5 million, to Nicolas Doneff, Anton Doneff, and Sarah Bonovich (ND, AD, and SB) via quit claim deed. The return claimed a transfer fee exemption. On the same day, a second return was filed regarding the December 2015 "reincorporation" of the property in connection with which ND, AD, and SB transferred the property, again via quit claim deed, to a newly formed entity, Southbrook Apartments LLC (SA), owned by ND, AD, and SB in the same proportions in which they owned Southbrook. The return filed for the second conveyance also claimed a transfer fee exemption. The DOR did not accede to either of the claimed exemptions. In fact, it issued two notices of assessment, totaling nearly $46,000, in which it asserted transfer fee deficiencies for each of the conveyances. ND, AD, and SB later filed a correction instrument. This document purported to modify the first deed to reflect a transfer from Southbrook to SA, instead of from Southbrook to its owners and then from those owners to SA. The DOR did not give the correction instrument any credence and imposed fees in accordance with the form in which the transactions were cast — that is, two separate conveyances, each of which incurred its own separate transfer fee.

Wisc. Stat. section 77-25 provides, in part, that "the fees imposed by this subchapter do not apply to a conveyance . . . pursuant to the conversion of a business entity to another form of business entity if, after the conversion, the ownership interests in the new entity are identical with the ownership interests in the original entity preceding the conversion."

The WTAC readily acknowledged that "the ultimate goal of these transactions was to convey the Property from [Southbrook] to SA." That was the intended result from the outset, and that is precisely what the parties accomplished, albeit in a circuitous way.

[3] *Doneff v. Wisconsin Department of Revenue*, Dkt No. 18-T-059 (Wisc. Tax App. Comm. Feb. 7, 2020).

The plaintiffs sought via the filing of the correction instrument to convince the WTAC that both the form and substance of the transaction were a direct transfer of the property from Southbrook to SA. The WTAC, however, rejected the contention advanced by the plaintiffs that a correction instrument can be used "to change the nature of the transaction." Instead, the WTAC held the parties to the form in which they themselves had cast the transaction; because the transaction encompassed two recorded deeds and therefore two separate transactions, each properly attracted a transfer fee.

These transactions, however, followed the classic "liquidation/reincorporation" pattern in which there are distributions to an entity's owners of the entity's properties, which are followed by the prearranged transfer of the distributed property to another entity that they own in the same proportions as they owned the "liquidating" entity. The transaction has historically been recharacterized and treated as if the distributing corporation instead had effected the transfer, with the owners serving as merely a conduit to convey the property to its ultimate destination, the successor entity.

The WTAC, however, was unwilling to view the transaction in this manner. It placed controlling weight on the fact that the transaction featured two separate deeds, not merely a single deed under which the property went directly from Southbrook to SA.

However, the argument for viewing the transaction in accordance with its substance seems particularly compelling here. The owners of Southbrook owned the property for only the briefest of moments — in fact, they divested the property on the same day they received it. It is undisputed that the ownership of the property by ND, AD, and SB was transitory and without substance; they held the property "as a fund they were bound to pass on" to SA and did not, as far as we can tell, have the right to do anything with the property other than convey it to SA. The preliminary distribution was "a meaningless and unnecessary incident in the transmission of the Property to SA, all along intended to come to its hands. . . . The owners were merely intermediaries in the transfer of the Property to SA. The receipt of the Property by them and their prompt and preplanned re-conveyance of the Property should be treated as a direct transfer of the Property by [Southbrook] to SA."[4]

The transfer fee exemption should have been available to these parties. While we understand that taxpayers are sometimes bound by the form in which they themselves cast their transactions, that rule is premised on the fact that the form, however improvident, has substance. Here, however, the form in which the transactions were cast has not a shred of substance because ND, AD, and SB's ownership of the property distributed to them in the Southbrook liquidation was transitory — they had no discretion to do anything with the property other than to convey it to SA. In that situation, the form should give way to substance, which here was a direct transfer from Southbrook to SA. It should be fully eligible for Wis. Stat. section 77-25's transfer fee exemption available for conveyances that take place "pursuant to the conversion of a business entity to another form of business entity" in which, after the conversion, the same persons own the interests in the predecessor and successor entities in the same proportions. ■

[4] *See Minnesota Tea Co. v. Helvering*, 302 U.S. 609 (1938); and Rev. Rul. 75-450, 1975-2 C.B. 328.