Updates
June 17, 2020

Changes to Washington Estate Tax Treatment of Real Property Owned by Business Entities

The Washington Department of Revenue (DOR) on May 28, 2020, published a Special Notice advising that beginning June 1, 2020, in determining a decedent's taxable estate for Washington estate tax purposes, the DOR will treat a business entity holding real property as an intangible asset regardless of whether the business entity served a true business purpose. Because the Special Notice refers only to real property, it is not clear whether or to what extent the new policy will apply to tangible personal property, such as vehicles or artwork, owned by business entities.

Prior guidance advised that the DOR applied a "true business purpose" test to determine whether a business entity holding real property was considered an intangible asset. If a business entity holding real property was not operating for a true business purpose, it would be considered a tangible asset. (For example, an LLC holding a family vacation home would be treated as a tangible asset, while an LLC holding real property used in an active business would be an intangible asset.) Under the new guidance, even if the business entity holding real property was not operating for a true business purpose, it would still be considered an intangible asset.

For estates where the decedent died before June 1, 2020, and an estate tax return was filed but the estate was not closed before June 1, 2020, taxpayers may file an amended return that addresses the business entity interests affected by the new policy as long as the amended return is filed within the statute of limitations period. If such taxpayers choose not to amend the return, the estate will not be billed for any additional tax due to the policy change if a good faith effort was made to comply with the DOR's prior guidance. In the case of estates where the decedent died before June 1, 2020, and no estate tax return has been filed, the estate will not be billed for any additional tax due to the policy change if the estate makes a good faith effort to comply with the DOR's prior guidance. If an estate's decedent dies between June 1, 2020, and November 30, 2020, the new policy applies but estate tax reporting under the prior guidance will be accepted if there is a good faith effort to comply with the DOR's prior guidance. Finally, for estates where the decedent dies after November 30, 2020, only the new policy applies.

Washington Estate Tax Treatment of Tangible and Intangible Property

The changes in the Special Notice may make it more—or less—advantageous to hold real property in a business entity, such as an LLC, for Washington estate tax purposes. This analysis will differ for individuals domiciled in and outside of Washington state.

Washington Residents: For Washington residents, intangible property is subject to Washington estate tax regardless of where the property is located. Tangible property physically situated in Washington is subject to estate tax, while tangible property situated outside of Washington results in an apportionment of the estate tax attributable to that property, reducing the estate tax due.

Non-Washington Residents: For non-Washington residents, intangible property is not subject to Washington estate tax regardless of where the property is located. Tangible property will only be subject to Washington estate tax if it is physically situated in Washington state.

Planning Opportunities

Washington residents may be able to avoid Washington estate tax on out-of-state real property by holding it outright or in a trust structure rather than in a business entity.[1]

Non-Washington residents may be able to avoid Washington estate tax on Washington real property by holding it in a business entity.[2] Interests in the business entity may then be transferred to a trust structure for further planning.

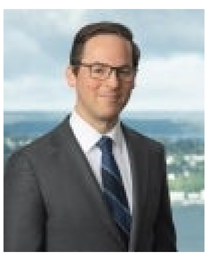
Individuals should review their current holding structures for real and tangible personal property and consult with an experienced estate planning attorney to address their individual concerns relating to the Special Notice.

Endnotes

[1] Further consideration must be given to determine whether Washington residents should hold real property in or outside of a business entity. In making this determination, the potential Washington estate tax benefits of holding real property outright or in a trust must be considered and weighed against the loss of the potential liability protection benefits provided by the business entity structure.

[2] Further consideration must be given for individuals who are non-U.S. domiciliaries. Holding U.S. property in certain U.S. entities may have adverse tax consequences in an individual's country of domicile. Individuals in this situation should consult with an experienced attorney with international estate planning experience.

Authors



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