

**Information Notice**  
**Realty Transfer Tax 2014-01**

**Real Estate Company Acquisitions after Act 52 of 2013**  
**Issued: October 17, 2014**

General Overview

Act 52 of 2013 was signed into law on July 9, 2013. Act 52 made numerous changes to the Tax Reform Code of 1971, including changes to the Realty Transfer Tax rules related to real estate company acquisitions. The changes related to the real estate company acquisitions became effective on January 1, 2014.<sup>1</sup>

Purpose

The purpose of this notice is to explain the Act 52 changes related to real estate companies and real estate company acquisitions for Pennsylvania realty transfer tax.

Summary of Changes

Act 52 made the following changes related to real estate companies and real estate company acquisition rules for Pennsylvania Realty Transfer Tax purposes:

1. Gross Receipts and Asset Tests: It clarified that a real estate company is determined by taking into consideration its real estate everywhere, not just real estate located in Pennsylvania.
2. Expanded Definition of Real Estate Company: It provides that a corporation or an association can be a real estate company even if it doesn't own real estate. Now, a corporation or association that is owned by thirty-five or fewer persons and which has assets 90 percent of the fair market value of which are interests in one or more real estate companies is a real estate company.
3. Binding Commitments and Options: It provides that a legally binding commitment or option to transfer an interest in a real estate company, enforceable at a future date, is deemed a transfer of an interest in a real estate company at the time of the execution of the commitment or grant of the option.

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<sup>1</sup> Local Realty Transfer Tax under Article XI-D of the Tax Reform Code mirrors the State Realty Transfer Tax Law. Therefore, Act 52's changes also apply to Local Realty Transfer Tax. The Department has the authority to assess and collect Realty Transfer Taxes for the local municipalities (not including the City of Philadelphia) and school districts.

## GROSS RECEIPTS AND ASSET TESTS

Historically, the only way for a corporation or an association to be a real estate company was if the corporation or association directly owned real estate and it was primarily engaged in the business of holding, selling or leasing the real estate. If a corporation or association satisfied this criterion, there were two tests used to determine if a corporation or association holds sufficient real estate to be considered a real estate company—the gross receipts test and the asset test. Under these tests, the corporation or association must either:

1. Derive sixty per cent or more of its annual gross receipts from the ownership or disposition of real estate (“gross receipts” test); or
2. Hold real estate, the value of which comprises ninety per cent or more of the value of its entire tangible asset holdings exclusive of tangible assets which are freely transferable and actively traded on an established market (“asset” test).

Act 52 clarified that these two tests are applied to the corporation or association’s entire real estate holdings, not just Pennsylvania real estate.

It should be noted that even though the corporation or association’s entire real estate holdings are used to determine if the corporation is a real estate company, the Pennsylvania Realty Transfer Tax that is imposed upon the acquisition of a real estate company is only imposed upon the value of company’s Pennsylvania real estate.

## EXPANDED DEFINITION OF REAL ESTATE COMPANY

After Act 52, a corporation or association can be a real estate company (even if it doesn’t own real estate) by virtue of its direct ownership interest in a real estate company or ownership in a real estate company through a tiered structure.

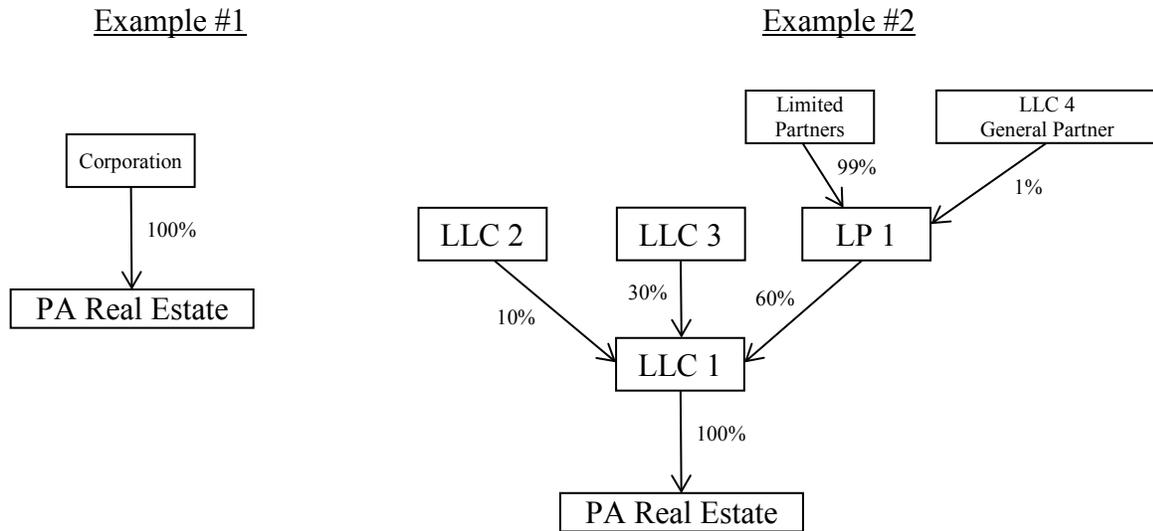
Under Act 52, a corporation or association is a real estate company if:

1. Ninety per cent or more of the ownership interest in the corporation or association is held by thirty-five or fewer persons, and
2. The corporation or association owns, as ninety per cent or more of the fair market value of its assets, a direct or indirect interest in a real estate company.

## Examples of Real Estate Company Structures

In the following examples, it is assumed that all of the corporations or associations are owned by thirty-five or fewer people and their sole assets are real estate or interests in their respective corporation or association.

In Example #1 below, Corporation is a real estate company due to its direct ownership of Pennsylvania Real Estate. In Example #2, LLC 1 is a real estate company due to its direct ownership of Pennsylvania Real Estate. Further, LLC 2, LLC 3 and LP 1 are all real estate companies due to their ownership in LLC 1, which is a real estate company. LLC 4 is also a real estate company due to its ownership of LP 1, which is a real estate company.

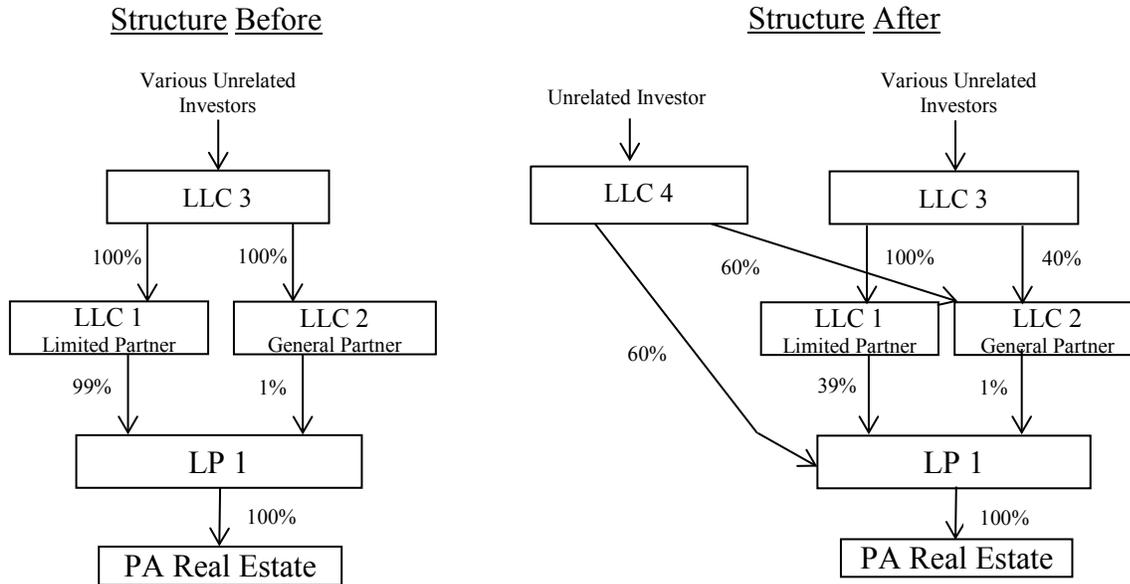


### Real Estate Company Acquisitions

For Realty Transfer Tax purposes, tax is imposed upon the value of a real estate company’s Pennsylvania real estate when the real estate company is acquired. An acquisition occurs when ninety percent or more of the ownership interest in the real estate company changes within a three year period.

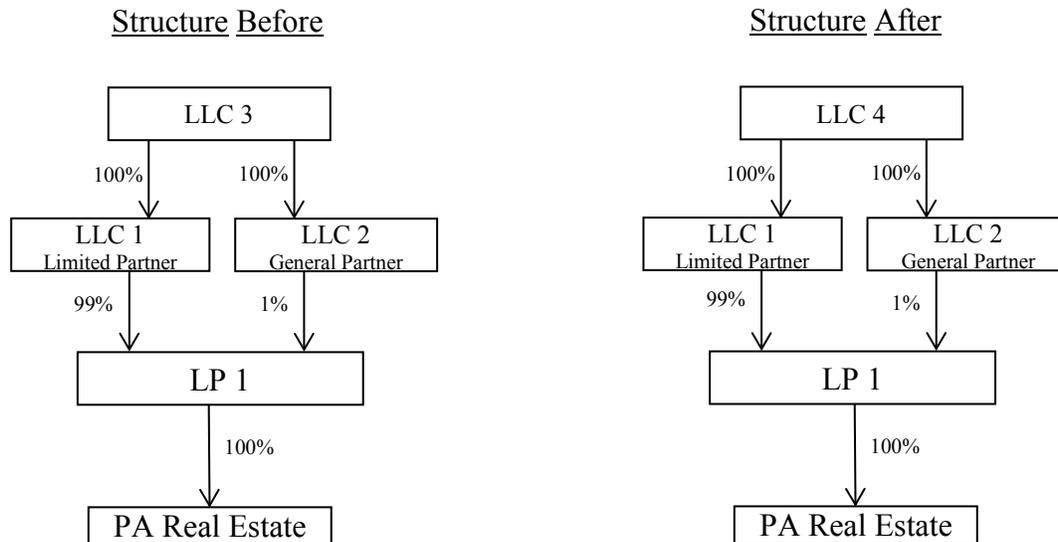
For Pennsylvania Realty Transfer tax purposes, the Department does not “look through” real estate companies (“tiers of ownership”) to determine if the company has been acquired. The Department only looks to direct changes in ownership of the real estate company itself. (A corporation or association that owns an interest in a real estate company may itself be a real estate company that can become acquired, but the Department will not look to ownership changes in upper-tiered entities to determine if an acquisition of a lower-tiered real estate company has occurred.)

### Example #3



In the “Before” structure above, LP 1 is the only entity that directly owns Pennsylvania real estate. LP 1 is a real estate company. LLC 1, LLC 2 and LLC 3 are all real estate companies by virtue of their ownership in LP 1. In the “After” structure, LLC 4 acquires a 60% ownership interest in LP 1 (it acquires 60% of LLC 1’s ownership interest in LP 1) and a 60% ownership interest in LLC 2 (it acquires 60% of LLC 3’s ownership interest in LLC 2). In this example, the Department looks to each tier of ownership to determine if an acquisition has occurred. Because there has only been a direct 60% ownership change in LP 1, there is no acquisition of LP 1. Further, because there is only a direct 60% ownership change of LLC 2, there is no acquisition of LLC 2. The 60% change of LP 1 and the 60% change in ownership of LLC 2 are not combined together to determine if an acquisition has occurred because the acquisitions occur on different tiers of ownership.

#### Example #4



In the “Before” structure above, LP 1, LLC 1, LLC 2 and LLC 3 are all real estate companies. LP 1 is the only real estate company that directly owns Pennsylvania real estate. In the “After” structure, LLC 4 purchases LLC 3’s interests in LLC 1 and LLC 2. In this case, LLC 1 and LLC 2 are acquired real estate companies. LP 1 is not an acquired real estate company because LLC 1 and LLC 2 remain the owners of Real Estate LP 1.

#### Three Year Look-Back Rule

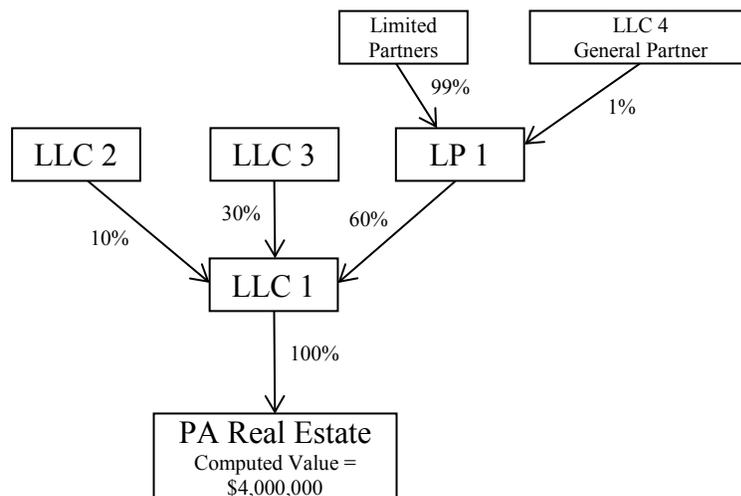
For purposes of determining if a corporation or association is an acquired real estate company, changes of ownership interest are only counted if they occur during a period when the corporation or association is a real estate company. For example, if in a three year period 30% of the stock ownership of a real estate company changes hands in year 1 and 65% changes hands in year 3, the company is acquired because there has been a 95% change within a three year period. However, under those same facts, if the company was not a real estate company during year 1, then the company would not be an acquired real estate company because 30% (of the 95%) was acquired when the company was not a real estate company.

Some corporations and associations that were not real estate companies will become real estate companies after the effective date of Act 52. When applying the three year look-back period for real estate company acquisition purposes, the Department will not look to changes of ownership interests in such corporations or associations prior to January 1, 2014, when those corporations and associations were not real estate companies.

## Valuation

When a real estate company is acquired, realty transfer tax is imposed upon the computed value<sup>2</sup> of the company's real estate located in the Commonwealth. After Act 52, a real estate company may own Pennsylvania real estate either directly or indirectly through its ownership of interests in other real estate companies. In cases where a real estate company becomes acquired, it must pay tax on the computed value of real estate it owns directly and on the computed value of real estate it owns indirectly through its ownership in other real estate companies. The taxable value of real estate owned indirectly will be the computed value of the real estate multiplied by the real estate company's proportionate ownership interest in the real estate company that owns the Pennsylvania real estate directly.

### Example #5



LLC 1, LLC 2, LLC 3, LLC 4 and LP 1 are all real estate companies. LLC 1 is the only real estate company that directly owns Pennsylvania real estate. All the other companies are real estate companies by virtue of their ownership in LLC 1. If LLC 1 becomes an acquired real estate company, tax would be imposed upon the \$4,000,000 computed value of the Pennsylvania real estate that it owns. If one of the other companies would become acquired, tax would be imposed upon the proportion of the \$4,000,000 computed value of the Pennsylvania real estate that it owns through LLC 1. Acquisition of those entities would result in tax on the following values:

- LLC 2:  $\$4,000,000 \times 10\% = \$400,000$
- LLC 3:  $\$4,000,000 \times 30\% = \$1,200,000$
- LP 1:  $\$4,000,000 \times 60\% = \$2,400,000$
- LLC 4:  $\$4,000,000 \times (60\% \times 1\%) = \$24,000$

<sup>2</sup> Computed value is real estate's assessed value for local real estate tax purposes adjusted by the common level ratio of assessed values to market values of the taxing district as established by the Pennsylvania State Tax Equalization Board.

## BINDING COMMITMENTS AND OPTIONS

Another significant change under Act 52 is that the execution of a legally binding commitment (an executory agreement) or the grant of an option to transfer an interest in a real estate company at a future date is deemed to be a transfer of an interest in a real estate company at the time of the execution of the commitment or grant of the option. It is irrelevant whether the option is ever exercised or if the interest in the real estate company under executory agreement or option is ever transferred. The execution of the agreement or the grant of the option is deemed a transfer of the interest at the time the agreement is executed or the option is granted.

A legally binding commitment or option should be distinguished from a mere non-binding agreement to negotiate a future transfer of an interest in a real estate company. The former triggers a deemed transfer of the interest in the real estate company, where the latter does not. In order to be a non-binding agreement to negotiate a future transfer, the parties must be free to fully negotiate for the transfer of interests in a real estate company in the future. The terms of the transfer may not be established in advance and all parties must be free to accept or reject any or all terms of the future transfer.