



July 11, 2007
Pennsylvania Realty Transfer Tax
No. RTT-07-005
Conversions and Mergers of Business Entities

ISSUES:

1. Is a document that confirms the conversion of a general partnership to a limited liability company subject to Pennsylvania Realty Transfer Tax?
2. Is a document that confirms the conversion of a limited partnership to a limited liability company subject to Pennsylvania Realty Transfer Tax?
3. Is a document that evidences the merger of a limited liability company into another limited liability company subject to Pennsylvania Realty Transfer Tax?

CONCLUSIONS:

1. The document is not subject to tax as explained below.
2. The document is not subject to tax as explained below.
3. Given the facts provided, it is unclear whether the document would be subject to tax. Further explanation is provided below.

FACTS:

"General Partnership" is a general partnership whose assets consist of real property located in Pennsylvania. General Partnership has two general partners, "Partner #1" and "Partner #2" who are individuals. Partner #1 owns a 74.15% interest and Partner #2 owns the remaining 25.85% interest in General Partnership.

"Limited Partnership" is a Pennsylvania limited partnership whose assets consist of real property located in Pennsylvania. The general partner of Limited Partnership is "LP LLC", a Pennsylvania limited liability company. LP LLC has a 1% interest in Limited Partnership. LP LLC is wholly owned by Partner #1. The limited partners of Limited Partnership are Partner #1 and Partner #2, who own 73.15% and 25.85% of the total limited partnership interests, respectively.

It is assumed for purposes of this letter that both General Partnership and Limited Partnership are real estate companies as defined in 72 P.S. § 8101-C and 61 Pa. Code § 91.201.

Partner #1 and Partner #2 desire to convert the form of both General Partnership and Limited Partnership to limited liability companies, and thereafter to merge the two limited liability companies. It is contemplated that the transactions would involve three steps as follows:

1. Conversion of General Partnership from a general partnership to a limited liability company. To effectuate the conversion, Partner #1 and Partner #2 contemplate forming a

"shell" limited liability company ("Newco 1 LLC") into which General Partnership will merge under New Jersey state law. Newco 1 LLC will be owned in the same percentages as General Partnership - 74.15% by Partner #1 and 25.85% by Partner #2. Partner #1 and Partner #2 will have the same respective management rights and obligations with respect to Newco 1 LLC as they had with respect to General Partnership.

The conversion is not intended to transfer any ownership interest in real estate or any other property.

2. Conversion of Limited Partnership from a limited partnership to a limited liability company. To effectuate the conversion, Partner #1 and Partner #2 contemplate forming a another "shell" limited liability company ("Newco 2 LLC") into which Limited Partnership will merge under Pennsylvania state law. Partner #1 and Partner #2 will own Newco 2 LLC in the same percentages as the direct and indirect interests in Limited Partnership - 74.15% by Partner #1 and 25.85% by Partner #2. Partner #1 will manage Newco 2 LLC (because Partner #1 owned all of the interests of the general partner of Limited Partnership, he had management authority with respect to Limited Partnership; therefore, he will continue to have such authority with respect to Newco 2 LLC). Thus, Partner #1 and Partner #2 will have the same economic interests and management rights with respect to the Newco 2 LLC as they had in Limited Partnership.

The conversion is not intended to transfer any ownership interest in real estate or any other property.

3. Merger of Newco 1 LLC with and into Newco 2 LLC. Following the conversions of General Partnership and Limited Partnership to Newco 1 LLC and Newco 2 LLC, it is contemplated that Newco 1 LLC will be merged with and into Newco 2 LLC with Newco 2 LLC surviving the merger.

For purposes of this ruling, it is assumed that all of the above transactions will be effectuated for no or only nominal consideration.

DISCUSSION:

The Department has consistently taken the position that a business entity may change its business form, i.e., a "conversion." As long as the conversion meets certain criteria, a document that is filed merely to confirm the entity's existing ownership of Pennsylvania real estate following the conversion is not subject to Pennsylvania Realty Transfer Tax. For example, see prior letter rulings RTT-05-012, RTT-06-001 and RTT-06-005.

The contemplated conversions of General Partnership into Newco 1 LLC and Limited Partnership into Newco 2 LLC are consistent with the Department's criteria for converting a business entity and the subsequent filing of a non-taxable confirmatory deed. Therefore, any document that is filed to confirm General Partnership and Limited Partnership's current ownership of Pennsylvania real estate following the conversion of those business entities to Newco 1 LLC and Newco 2 LLC are excluded documents and will not be subject to Pennsylvania Realty Transfer Tax.

Article XI-C of the Tax Reform Code provides that a document that effectuates or evidences the transfer of title to real estate "pursuant to the statutory merger or consolidation of a

corporation or statutory division of a nonprofit corporation” is not subject to Pennsylvania Realty Transfer Tax. 72 P.S. § 8102-C.3(12). The statutory exclusion applies regardless of whether the corporations are affiliated or have identical or similar ownership. The statutory exclusion will not apply, however, “where the department reasonably determines that the primary intent for such merger, consolidation or division is avoidance” of the Pennsylvania Realty Transfer Tax. Id. It is not necessary that the intent to avoid tax be fraudulent or nefarious. All that is required is that the avoidance of tax is the primary purpose.

In this case, Taxpayers contemplate merging General Partnership and Limited Partnership after their conversion to Newco 1 LLC and Newco 2 LLC. Because Newco 1 LLC and Newco 2 LLC are limited liability companies, they are considered corporations for Pennsylvania Realty Transfer Tax purposes. 15 Pa.C.S. § 8925(a). Therefore, on its face, the merger of Newco 1 LLC into Newco 2 LLC appears to qualify for the corporate merger exclusion. However, Taxpayer did not provide any significant facts regarding the business purposes for which the series of transactions outlined above are being effectuated. If it can be assumed that there is some legitimate business purpose for the above outlined transactions other than the mere transfer of the real estate of General Partnership / Newco 1 LLC to Limited Partnership / Newco 2 LLC, then any document that effectuates or evidences the merger will not be subject to Pennsylvania Realty Transfer Tax.

Nevertheless, without additional facts of a legitimate business purpose for the conversions and the merger, this series of transactions is suspect. Because there is no realty transfer tax exclusion for the merger of partnerships and because General Partnership and Limited Partnership will be converted immediately before the merger of Newco 1 LLC and Newco 2 LLC, it is reasonable to draw the inference that the sole purpose for the conversion of General Partnership and Limited Partnership to limited liability companies is to change their business form so that Taxpayers can take advantage of the corporate merger exclusion. Further, because General Partnership and Limited Partnership, in their current form and in their subsequent converted forms, are real estate companies, there is a strong inference that the sole purpose for merging the one real estate company into the other is the mere transfer of real estate.[1] In fact, in situations involving the merger of real estate companies, it is difficult to conceive of a business purpose that would justify the merger other than the transfer of real estate. For these reasons and without additional information to support a business purpose for the merger other than the transfer of real estate, the Department reasonably would be justified in making a determination that the primary intent of the merger of Newco 1 LLC into Newco 2 LLC is the avoidance of Pennsylvania Realty Transfer Tax. Therefore, the corporate merger exclusion would not apply to the merger.

This letter ruling is not intended to suggest that all mergers are inherently suspect of being a mechanism for tax avoidance just because entities to the merger own real estate. There are many situations in which a merger serves a legitimate business purpose and the transfer of real estate is merely an incidental consequence of the merger. The Department’s review of the primary business purpose of a merger is a fact sensitive one that is made on a case by case basis.

[1] In 1986, the Pennsylvania Legislature amended Article XI-C of the Tax Reform Code to provide for the taxation of real estate companies upon their acquisition. Act 77 of 1986 (Act of July 2, 1986, P.L. 318, No. 77). In making

these amendments, the Legislature indicated that a real estate company (an entity that is primarily engaged in the business of holding, selling or leasing real estate and that derives the majority of its gross receipts from real estate or that has few tangible assets other than real estate) is effectively the equivalent of the real estate it owns. Therefore, a transfer of the interest in the real estate company is the equivalent of a transfer of the company's real estate itself.