



April 29, 2009
Pennsylvania Realty Transfer Tax
No. RTT-09-004
Merger of Non-Profit, Non-Stock, Non-Member Corporations

ISSUE:

Will the merger of a Pennsylvania non-profit, non-stock, non-member corporation whose sole purpose is to hold Pennsylvania real estate with and into another Pennsylvania non-profit, non-stock, non-membership corporation result in any Realty Transfer Tax liability?

CONCLUSION:

Based upon the facts provided, the merger will not result in Realty Transfer Tax liability as explained more fully below.

FACTS:

Taxpayer 1 is a Pennsylvania nonprofit, non-stock, non-membership corporation that is a federal income tax exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended ("Code").

Taxpayer 1 incorporated Taxpayer 2. The purpose of Taxpayer 2 is to acquire and hold real estate for Taxpayer 1.

Taxpayer 2 was incorporated as Pennsylvania nonprofit, non-stock, non-membership corporation that is a federal income tax exempt organization under Section 501(c)(2) of the Code. In order to be a Section 501(c)(2) tax exempt entity, the entity must be organized to hold title to property for a federally tax exempt organization. IRC § 501(c)(2).

Taxpayer 1, acting through its Board Chair, appoints Taxpayer 2's entire Board of Directors. In addition, Taxpayer 1 may remove and replace Taxpayer 2's Board of Directors at any time without cause.

Upon Taxpayer 2's dissolution, its assets are to be distributed to Taxpayer 1.

In 2006, Taxpayer 2 purchased a parcel of real estate and paid Pennsylvania Realty Transfer Tax on the deed of transfer. Taxpayer 1 contributed 100% of the funds to Taxpayer 2 to acquire the real estate. The real estate is Taxpayer 2's only significant asset.

Taxpayers have indicated that the sole occupant of the real estate is Taxpayer 1. It is assumed that Taxpayer 2 leases the real estate to Taxpayer 1. Taxpayer 1 pays no rent to Taxpayer 2.

Taxpayers have determined that it is not necessary for a separate corporation to own the real estate. Taxpayers believe that merging Taxpayer 2 into Taxpayer 1 will reduce their combined operating expenses, such as accounting and legal fees. In addition, if Taxpayer 1 takes ownership and use of the real estate, it is expected that the real estate will qualify for an exemption for local real estate tax. Accordingly, Taxpayers propose to enter into a Plan

of Merger whereby Taxpayer 2 will merge with and into Taxpayer 1. Taxpayer 1 will survive the merger.

As a result of the merger, title to the real estate will pass from Taxpayer 2 to Taxpayer 1 by operation of law. Taxpayers anticipate that they will execute a deed to evidence the transfer of title to the real estate from Taxpayer 2 to Taxpayer 1 as a result of the merger.

DISCUSSION:

Any document that effectuates or evidences the transfer of title to real estate located in the Commonwealth is subject to Pennsylvania Realty Transfer Tax. 72 P.S. § 8102-C. A taxable document includes a document that evidences the conveyance of title to real estate by operation of law. 61 Pa. Code § 91.171.

In this case, Taxpayers propose to merge Taxpayer 2 into Taxpayer 1. Under Pennsylvania law, the ownership and title to assets of an acquired corporation pass by operation of law to the corporation into which it merges. 15 Pa.C.S. § 1929. As a result, in the case of real estate, there is no need to execute a deed to convey real estate of an acquired corporation. Title to the real estate passes by operation of law to the acquiring corporation.

Nonetheless, it is common practice to execute and record a deed to provide public notice of the transfer of title to the real estate from the one corporation to the other. Because such documents evidence the transfer of title by operation of law, the documents are taxable. Consequently, any document that Taxpayers execute to evidence the transfer of title to the real estate from Taxpayer 2 to Taxpayer 1 as a result of the merger is taxable absent an applicable tax exemption.

Under the Realty Transfer Tax law, a document that effectuates or evidences the transfer of title to real estate pursuant to the statutory merger of corporations is exempt from tax. 72 P.S. § 8102-C.3. Because Taxpayer 1 and Taxpayer 2 are corporations, this exemption is potentially applicable to Taxpayers' proposed merger.

There is an exception to the merger exemption, however. A document is not exempt from tax if "the department reasonably determines that the primary intent for such merger . . . is avoidance of" the Realty Transfer Tax. Id. The statutory language of the exception does not provide any criteria upon which the Department is to base its determination, nor does it provide guidance as to when a merger is primarily intended to avoid Realty Transfer Tax. The exception merely requires that the Department must make a reasonable determination.

The Department has provided some additional guidance regarding the exception to the merger exemption in its realty transfer tax regulations. The regulations provide the following:

(b) Additional exclusions. Other transactions which are excluded from tax include:

* * *

(12) A transfer under the statutory merger or consolidation of a corporation or statutory division of a nonprofit corporation if:

* * *

(iii) The document merely confirms that an interest in real estate passed by operation of law to a new or surviving corporation under a statutory merger or consolidation, unless the primary intent for the merger or

consolidation is avoidance of the Realty Transfer Tax. See 15 Pa.C.S. § § 1929 and 4127 (relating to effect of merger or consolidation; and merger, consolidation or division of qualified foreign business corporations) and 15 Pa.C.S. § 5929(b) (relating to effect of merger or consolidation). In determining whether a merger or reorganization is undertaken to avoid tax, the Department will consider the following factors:

(A) Is one or more of the corporations which are parties to the reorganization a real estate company, an acquired real estate company, a family farm corporation or an acquired family farm corporation.

(B) Does the merger or consolidation, of itself or together with other changes in interest, have the effect of transferring directly or indirectly, 90% or more of the total ownership rights in the real estate company, acquired real estate company family farm corporation or acquired family farm corporation.

61 Pa. Code § 91.193(b)(12).

In this case, Taxpayers did not provide any facts or evidence to suggest that Taxpayer 1 or 2 is a family farm corporation.[1] However, there was evidence to suggest that Taxpayer 2 could be a real estate company.[2] Taxpayer 2's sole purpose is to hold property for Taxpayer 1 (in this case, real estate). This is evidenced by the fact that Taxpayer 2 has no other significant business assets. Taxpayer 2's purpose as a real estate holding company is also evident from its IRC § 501(c)(2) federal tax exempt status. Further, Taxpayer 2's primary asset is real estate. Despite those facts, Taxpayer 2 is not a real estate company.

The real estate company rules were added to the Realty Transfer Tax law in 1986 to prevent the abusive tax practice of conveying real estate to corporations and associations and subsequently conveying the real estate by transferring the ownership interest in the corporation or association without having to execute a taxable document of transfer. Thus, the real estate company rules envision the existence of a corporation or association with transferable ownership interests. Such a corporation or association is required to effectuate the abusive tax practice.

Because Taxpayer 2 is a non-stock, non-member corporation there are no ownership interests to transfer. Therefore, Taxpayer 2 is not a vehicle that could be used to effectuate the abusive tax practice that the real estate company rules were designed to address. As a result, Taxpayer 2 is not a real estate company, and the factors in clauses (A) and (B) above are not applicable to this situation. Consequently, any document that is executed to evidence the transfer of title to real estate by operation of law as the result of Taxpayer 2's merger with and into Taxpayer 1 will be exempt from tax as a result of the merger exclusion.

[1] "Family Farm Corporation." A corporation of which at least seventy-five per cent of its assets are devoted to the business of agriculture and at least seventy-five per cent of each class of stock of the corporation is continuously owned by members of the same family. The business of agriculture shall include the leasing to members of the same family of property which is directly and principally used for agricultural purposes. The business of agriculture shall not be deemed to include:

(1) Recreational activities such as, but not limited to, hunting, fishing, camping, skiing, show competition or racing;
(2) The raising, breeding or training of game animals or game birds, fish, cats, dogs or pets or animals intended for

use in sporting or recreational activities;

(3) Fur farming;

(4) Stockyard and slaughterhouse operations; or

(5) Manufacturing or processing operations of any kind.

72 P.S. § 8101-C.

[2] "Real estate Company." A corporation or association which is primarily engaged in the business of holding, selling or leasing real estate ninety per cent or more of the ownership interest in which is held by thirty-five or fewer persons and which:

(1) derives sixty per cent or more of its annual gross receipts from the ownership or disposition of real estate; or

(2) holds 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.

72 P.S. § 8101-C.